IMPACTS OF THE CURRENT SOCIAL SECURITY SYSTEM

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

FEBRUARY 2, 3, AND 10, 1999

Serial 106–8

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE
57–366 CC WASHINGTON : 1999

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TODAY'S CHILDREN

TUESDAY, FEBRUARY 2, 1999

House of Representatives,
Committee on Ways and Means,
Subcommittee on Social Security,
Washington, DC.

The Subcommittee met, pursuant to notice, at 3:07 p.m., in room 1100, Longworth House Office Building, Hon. E. Clay Shaw, Jr. (Chairman of the Subcommittee), presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE CONTACT: (202) 225–9263
January 26, 1999
No. SS–1

Shaw Announces Hearing Series on Impacts of Current Social Security System

Congressman E. Clay Shaw, Jr., (R–FL), Chairman, Subcommittee on Social Security of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing series on impacts of the current Social Security system. The first hearing day in this series will focus on the impact of the current system on today's children as they take their place in the workforce and ultimately collect retirement benefits. The first hearing day will take place on Tuesday, February 2, 1999, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 3:00 p.m. Subsequent hearing days will be announced separately.

Oral testimony at the first hearing day on impacts on children will be heard from invited witnesses only. Witnesses will include program scholars, policy experts, and other informed citizens. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

Other hearing days are expected to focus on improving current protections for women, reducing poverty and protecting minorities and low-wage workers, and ensuring protections for survivors and individuals with disabilities. Further details will be released in subsequent announcements.

BACKGROUND:

Despite its remarkable success in combating poverty among the elderly, Social Security faces increasing hurdles in paying promised benefits in the coming years. As Social Security's Trustees stated in their April 1998 report, "Beginning with the year 2013, the tax income projected under present law is expected to be insufficient to cover program expenditures." By the year 2032, when the Trust Funds are projected to be depleted, tax collections will cover only 72 percent of benefit obligations. If changes are delayed until the year 2032, payroll tax hikes of 45 percent or benefit cuts of 25 percent or more would be required to maintain solvency. The burden could fall on younger workers, including today's children, who could face payroll tax increases or benefit reductions. Other undesirable effects on this group could include higher interest rates, fewer opportunities for savings, and lower returns on investments. Similar effects could also result from the transition to a reformed Social Security system.

In announcing the hearing, Chairman Shaw stated: "We need to examine closely how reforming the Social Security system affects not only current workers and retirees, but also our children and grandchildren. Leaving them a Social Security program that offers a lifetime of high taxes and low benefits is an unacceptable heritage. We must find a better way."

FOCUS OF THE HEARING:

The first hearing day will focus on how today's children are expected to fare under the current Social Security system. Witnesses are expected to discuss taxes and interest rates that today's children may face as adults, including trends on rising taxes as a share of personal income. In addition, witnesses will discuss benefits today's and tomorrow's children can expect when they retire, and the implications of high taxes and low savings for Social Security reform.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the close of business, Tuesday, February 16, 1999, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Social Security office, room B–316 Rayburn House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

—

Chairman SHAW. The Chair will call the hearing to order. I am sure that the other Members will be filing in shortly, as we are just coming back into town today from over a week off.

I would like to welcome everyone to the first of our Subcommittee hearings on the impact of Social Security and possible solutions to its solvency crisis. We have had other meetings of the Full Committee, but this is the first meeting that we have of the Subcommittee.

I want to add a special welcome to our new Members, including the new Ranking Member, Bob Matsui. I might say, too, that I am new to this Subcommittee this year.

Some might wonder why our first topic is the impact the retirement program has on children. So let me begin with a brief quote. "We now know that the Social Security Trust Fund is fine for another few decades. But if it gets in trouble and we don't deal with it, then it not only affects the generation of the baby boomers and whether they will have enough to live on when they retire, it raises a question of whether they will have enough to live on by unfairly burdening their children's ability to raise their grandchildren. That would be unconscionable."

Bill Clinton spoke these words almost 1 year ago. But the same could be said by every parent or grandparent. None of us wants to leave a harder life for our children, but that is the bitter prospect we face unless changes are made in Social Security. I would add also Medicare.

Consider the following: According to the 1998 Social Security Trustees' Report, by 2040—that is the year 2040—Social Security costs will rise to 18 percent of taxable payroll, a 63-percent increase over current benefit costs. That is just to pay the retirement costs of today's 25-year-olds, as well as junior baby boomers. By the time young Richard Anderson, who you will hear from later today, by the time he retires in 2060 or so, the youngest baby boomer will then be about 96 years old. If you want to feel old, that will do it. Will be 96. Yet Richard's children will have to surrender even more Social Security tax to support him unless action is taken soon.

So we know two things. This problem is serious, and it will not go away after the baby boomers have passed on. That, ladies and gentlemen, may be the good news. If economic growth rates worsen or, as everybody my age hopes, that life expectancy increases, our children and grandchildren will have to sacrifice even more. In fact, Richard and his classmates could spend their working years surrendering between 20 and 30 cents out of every dollar they make to support their parents' and their grandparents' retirement.

Add in Medicare and they could be paying 30 to 45 percent out of every dollar just in payroll taxes. That is before State and Federal income taxes. As the President said, that would be unconscionable. Everybody knows that would be unconscionable.

So let me say this at the outset: In reforming our Nation's Social Security system, we will protect current recipients and older workers. In the process, though, we must not saddle our children with huge liabilities. We must find a way both to keep our pledges to current retirees and to provide our children, our grandchildren, and the children of tomorrow with an even brighter future.

With that in mind, I welcome all of our guests here today to begin this journey that we will travel together in trying to solve what I consider to be the Nation's number one problem.

Is there anyone on the Minority side that cares to make an opening statement?

Mr. LEVIN. Mr. Chairman, I think Mr. Matsui wanted to do so. I believe he will be here fairly soon. So I would like if you would leave open the ability for him to participate, to give an opening statement when he arrives.

Chairman SHAW. Yes. I held opening the meeting for about 8 or 9 minutes, hopeful that he would be here, because I think this is important. I know Bob considers this to be very important. Certainly we will welcome any statement that he may wish to make.

Our first panel includes Richard K. Anderson, Sr. He is president of the Anderson Financial Services in Brooklyn, New York. Richard Anderson, Jr., vice president, Anderson Financial Services, Brooklyn, New York. I might say, Mr. Anderson, Jr., as far as we can tell in searching the records and Congressional Research Service, you are the youngest person ever to testify before the U.S. Congress.

Mr. ANDERSON, JR. Yes, I am.

Chairman SHAW. Tyra Brown, who is a student at the College of Arts and Science at Howard University, here in Washington; and Liz Kramer, the policy associate of 2030 Center.

Welcome to all of you. Mr. Anderson, Sr., if you would proceed. We have the written statement of the witnesses, which will be made a part of the record. We will welcome all of our guests to testify or proceed as they see fit.

Mr. Anderson.

STATEMENT OF RICHARD K. ANDERSON, SR., PRESIDENT, ANDERSON FINANCIAL SERVICES, BROOKLYN, NEW YORK

Mr. ANDERSON, SR. Thank you. Good afternoon, Mr. Chairman and distinguished Members of the House Subcommittee on Social Security. My name is Richard K. Anderson, Sr. I am the president of Anderson Financial Services in Brooklyn, New York. I am a graduate of Medgar Evers College of the City University of New York. I am currently on the faculty of the School of Continuing Education, where I teach personal financial planning basics and mutual fund investment. I am also the producer and host of Anderson's Biz Kids, a local public television show which showcases teenage money managers and entrepreneurs, as well as a frequent guest speaker at the New York Stock Exchange Teacher-to-Teacher Workshops.

Professionally, I am a member of the Institute of Certified Financial Planners, the American Society for Training and Development, the World Futures Society. I am also a trustee of the Securities Industry Foundation for Economic Education.

I am here to tell you today that when it comes to savings and investment education, the Nation's 50 million-plus youth grades K–12 have been largely ignored. They have been ignored primarily because many parents and society still believe the old notion that children should not have to worry about anything but school, playing, and just being young. Consequently, by the time our youth are old enough to take an interest in savings and investment, it is already too late. Many of them never catch up and live their entire lives thinking somehow, when the time comes, something called Social Security will take care of them.

A nationwide survey was conducted by a Lewis Mandell, Ph.D., an economist and researcher. He looked at 12th-graders' level of knowledge within four areas: income, money management, savings, and investment and spending. The survey results underscore the serious concerns about young people's ability to make educated financial decisions once they are out on their own. I find this alarming because it will most certainly translate the same condition into adulthood.

Let me pose this question: Who will take care of the financially illiterate in their old age? There is serious concern about whether the current system of Social Security will still be around for our children. Therefore, we must realize that financial security at retirement doesn't just happen. It takes planning, commitment, and, yes, money.

Let me share some facts with you. At the beginning of the century in the 1900s, half of all Americans died before the age of 50. Life expectancy for men in the 1900s was 46 years old, and 48 for women. By 1935, when the Social Security Act was conceived, life expectancy for men had risen to 60 years, and for women, 63. In 1945, there were only 771,000 retirees collecting Social Security. In 1946, only half of Americans could expect to live to age 67. In 1999, more than 50 percent of Americans will survive the age of 74. There are currently more than 35 million people collecting Social Security.

As you can see by these statistics, when Social Security was first conceived, most potential recipients were expected to be conveniently dead and buried before their Social Security ever kicked in. Few Americans imagined that the program would be asked to support millions of older people. Based on current projections, there will be 76 million people on Social Security by the year 2045, when my son Richard only turns 51.

Yes, people are living longer lives, which means they also are spending more time in retirement. A man who retires at age 65 today can expect to spend at a minimum 18 years in retirement. A woman who retires at age 65 today can spend 23 years in retirement. Those are just averages. Those are the current statistics. Who knows what the life expectancy will be in my son's lifetime and your children? They may routinely live to 100 and well past 100. Scientists are already projecting longer lives due to better technology and medical advances. As a result, our children may live half their lives in retirement. Let's face it, retirement has become an expensive process. The longer the retirement, the more expensive it becomes.

What can we do to address this looming crisis? The answer obviously is that people must begin to plan their retirements better and earlier. Education of our young about the necessity of planning for retirement must also begin at an early age. I don't know about you, but it is saddens me to know that less than half of all Americans have put aside money specifically for retirement. In 1993, of those who had 401(k) coverage available, one-third did not even participate.

American workers in general have a very limited degree of knowledge regarding retirement planning and saving. Because of this lack of knowledge and lack of planning, most Americans are not aware that Social Security accounts for about 38 percent at best of the average retiree's preretirement income. The rest must come from other sources. Unless we begin to educate the next generation early about the value of investing and saving, those other sources will never materialize.

The crisis is upon us, and only a concerted and committed effort to educate our Nation, especially our youth, about savings and investing can avert a potential disaster. Therefore, I urge this Subcommittee to seriously consider making the introduction of savings and investment education a part of every school curriculum.

Thank you very much, Mr. Chairman.

[The prepared statement follows:]

Statement of Richard K. Anderson, Sr., President, Anderson Financial Services, Brooklyn, New York

Good Afternoon Mr. Chairman and Distinguished Members of the House Subcommittee on Social Security.

My name is Richard K. Anderson, Sr. I am President of Anderson Financial Services in Brooklyn, New York. I am a graduate of Medgar Evers College of The City University of New York and I am currently on the faculty of the School of Continuing Education where I teach Personal Financial Planning Basics and Mutual Fund Investing Basics. I am the producer and host of "Anderson's Biz Kids," a public television show which showcases teenage money managers and entrepreneurs as well as a frequent guest speaker at the New York Stock Exchange Teacher Workshops. Professionally, I am a member of the Institute of Certified Financial Planners, the American Society for Training and Development and the World Future Society. I am also a trustee of the Securities Industry Foundation for Economic Education.

I am here to tell you today that when it comes to saving and investment education, the nation's 50 million plus youth in grades K–12, have been largely ignored. They have been ignored primarily because many parents and society still believe the old notion that children should not have to worry about anything but school, playing and being young. Consequently, by the time our youth are old enough to take an interest in savings and investment, it is already too late. Many of them never catch up and live their entire lives thinking that somehow, when the time comes, something called social security will take care of them.

A nationwide survey conducted by Lewis Mandell, Phd., an economist and researcher, looked at 12th graders' level of knowledge within four areas: income, money management, savings and investment and spending. The survey results underscore serious concerns about young people's ability to make educated financial decisions once they are out on their own. I find this alarming because it will most certainly translate into the same condition in adulthood.

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In 1945, there were only 771,000 retirees collecting social security. In 1946, only half of Americans could expect to live to age 67. In 1999, more than 50% of Americans will survive through the age of 74 and there are currently more than 35 million people collecting social security.

As you can see by these statistics, when Social Security was conceived, most potential recipients were expected to be conveniently dead and buried before their social security ever kicked-in. Few Americans imagined that the program would be asked to support millions of older people. Based on current projections, there will be 76 million people on social security by the year 2045 when my son, Richard, turns 51.

Yes, people are living longer lives, which means that they are also spending more time in retirement. A man who retires at age 65 can expect to live to at least 83 years old. That means that he will be spending, minimally, 18 years in retirement. A woman who retires at age 65 can expect to live to at least 88 years old. That means that she will be spending at least 23 years in retirement. Those are the current statistics. Who knows what the life expectancy will be in Richard's lifetime or your children's. They may routinely live to be 100 or well past 100. Scientists are already projecting longer lives due to better technology and medical advances. As a result, our children may live half their lives in retirement. Let's face it, retirement has become an expensive process and the longer the retirement, the more expensive it becomes.

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The crisis is upon us and only a concerted and committed effort to educate the nation, especially our youth, about saving and investing can avert a disaster. Therefore, I urge this committee to seriously consider making the introduction of saving and investment education a part of every school curriculum. Thank you Mr. Chairman.

—

Chairman SHAW. Thank you, Mr. Anderson.

I am going to recognize Mr. Anderson, Jr. Then we are going to have to break for vote. There are two votes that will be on the floor. But then we will return as quickly as possible.

Mr. Anderson, Jr.

STATEMENT OF RICHARD K. ANDERSON, JR., VICE PRESIDENT, ANDERSON FINANCIAL SERVICES, BROOKLYN, NEW YORK

Mr. ANDERSON, JR. Good afternoon, Mr. Chairman, and distinguished Members of the House Subcommittee on Social Security. My name is Richard K. Anderson, Jr. I am 6 years old. I want to thank you for inviting me to speak today on children and Social Security.

Some of you may be wondering why I am here today. You probably think at my age I don't have to worry about Social Security or retirement for a very long time. My father has taught me that you are never too young to begin to think about your future. On April 2, 1998, I became the youngest person ever to ring the bell and open the New York Stock Exchange. In May 1998, I appeared on CNBC. In July, I was on the Jay Leno Show.

When I was much younger, about 3 years old, my father would punish me for bad behavior by making me watch CNBC. Like any child, I wanted to watch my favorite cartoons. Now I am happy that my father punished me that way because now I know about the Dow Jones Industrials, stocks, mutual funds, and my dad's favorite subject, what makes a good company.

I know as a 6-year-old that it is important to save and invest at an early age. If you want to retire, you must save and invest. If you don't, you might have to work all your life. No one wants that.

It is important for all children to learn about investing in the S&P 500 and the Dow Jones. I know every company in the Dow Jones Industrials, what they produce, their competition, and most of the S&P 500. One day, I plan to have my own Richard's Kids Industrial Average. It would be just like the Dow Jones Industrial Average with 30 blue chip stocks like McDonald's, Caterpillar, Microsoft, Campbell Soup, Nike, Intel, and others. If I can make this dream come true, I will never have to worry about Social Security when I am old.

For all the children who think they are too young, hey, look at me. Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Richard K. Anderson, Jr., Vice President, Anderson Financial Services, Brooklyn, New York

My name is Richard K. Anderson, Jr. I am 6 years old and I want to thank you for inviting me to speak today on children and social security.

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It is important for all children to learn about investing in the S and P 500 and the Dow Jones. I know every company in the Dow Jones Industrial, what they produce, their competition and most of the S and P 500. One day, I plan to have my own "Richard's Kids Industrial Average." It would be like the Dow Jones Industrial Average with 30 blue chip stocks like: McDonalds, Caterpillar, Microsoft, Campbell Soup, Nike, Intel, and others. If I can make this dream come true, I will never have to worry about social security when I am old.

For all the children who think they are too young, hey, look at me!

Thank you Mr. Chairman.

—

Chairman SHAW. Richard, I thank you. As I said, we are going to have to break. As I had mentioned in some of my opening remarks, you not only are the youngest ever to open to the stock exchange, ring the bell at the stock exchange, but you are also the youngest ever to appear before Congress. I compliment your father for not punishing you by making you watch CSPAN.

We will now recess just long enough for the next votes. Then we shall return.

[Recess.]

Chairman SHAW. We will resume the hearing. They held that first vote, as it was the first vote of the day, so they held it open longer than we anticipated.

Ms. Brown.

STATEMENT OF TYRA BROWN, STUDENT, HOWARD UNIVERSITY

Ms. BROWN. Thank you, Mr. Chairman. I would like to thank the Subcommittee for inviting me here today to speak about the need to protect our Social Security system. It is a program that has touched my life and the lives of millions of other young people like myself.

My name is Tyra Brown. I am from Oklahoma City, Oklahoma. I am currently a junior at Howard University here in Washington, DC. In school, I am studying psychology, and I volunteer at a Head Start center, tutoring preschool children who are struggling with literacy skills and social development. After I earn my bachelor's degree from Howard, I plan to go on to graduate school and become a psychologist.

I enjoy working with children who need a helping hand. I believe that as an American family, we need to do what we can to help each other out. That is why I think Social Security is so important. It was there for me, and I want it to be there in the future.

Most people think of Social Security as a retirement program, and it is. But what a lot of people don't know is that Social Security also helps out millions of people like myself who are not retired. When I was 15, I experienced a terrible loss. My mother, who worked very hard to provide for me, passed away due to heart failure. My grandmother became my legal guardian and we received Social Security Survivor's Insurance to help us with expenses. It wasn't easy, but Social Security truly helped. We could count on that income to be there every month. Without it, we couldn't have made it.

When my mom was alive, she made a middle-class income and paid into the Social Security system, just like everyone else. She wasn't able to get her retirement benefits, but what she did get through Social Security Survivor's Insurance was my security after she died.

Mr. Chairman, I am not alone. There are millions of other survivors out there who count on Social Security every month. Now as I am beginning to think about my own future, I think about that guarantee. When I pay my Social Security taxes, I am not thinking about the best plan to get rich. I am thinking about the best plan for my economic security. I want to be sure that it will be there for my retirement or in case of any tragic circumstance, guaranteed.

I know that Social Security needs to be strengthened, and I know that there has to be a way to do it that preserves that vital guarantee. When I watched the President's State of the Union Address, I was glad to hear him say clearly that we must protect Social Security's guarantee. We constantly hear that Social Security won't be there for people my age when we need it. Well, it was there for me. I want to do my part to make sure it will be there in the future.

That is why I am here today, Mr. Chairman, to share my story and the stories of millions of other young people like myself who come from average families and who have dealt with extraordinary circumstances. As the Subcommittee considers reforms to the system, I respectfully encourage you to support the core values of Social Security, and work to make the program stronger. It is a system which we all contribute to and which we all benefit from, guaranteed.

Thank you.

[The prepared statement follows:]

Statement of Tyra Brown, Student, Howard University

Thank you Mr. Chairman. I would like to thank the Committee for inviting me here today to speak about the need to protect our Social Security system. It is a program that has touched *my* life and the lives of millions of other young people like myself.

My name is Tyra Brown. I'm from Oklahoma City, Oklahoma, and am currently a Junior at Howard University here in Washington, DC.

In school, I am studying psychology and I volunteer in a Headstart Center tutoring pre-school children who are struggling with literacy skills and social development. After I earn my Bachelor's degree from Howard, I plan to go on to graduate school and become a psychologist.

I enjoy working with children who need a helping hand, and I believe that as an American family, we all need to do what we can to help each other out. That is why I think that Social Security is so important. It was there for me, and I want it to be there in the future.

Most people think of Social Security as a retirement program-and it is. But what a lot of people don't know, is that Social Security also helps out millions of people, like myself, who are not retired.

When I was 15, I experienced a terrible loss. My mother, who worked hard to provide for me, passed away because of heart failure. My grandmother became my legal guardian and we received Social Security's survivors' benefits to help us with expenses. It wasn't easy, but Social Security really helped. We could count on that income to be there every month, and without it, we couldn't have made it.

When my mom was alive, she made a middle class income and paid into the Social Security system just like everyone else. She wasn't able to get her retirement benefits. But what she *did* get, through Social Security's survivor's insurance, was *my* security after she died.

And, Mr. Chairman, I am not alone—there are millions of other survivors out there, who count on Social Security every month.

Now, as I am beginning to think about my own future, I think about that guarantee. When I pay my Social Security taxes, I'm not thinking about the best plan to get rich. I'm thinking about the best plan for my economic security. I want to be sure that it will be there for my retirement or in case of a tragic circumstance-guaranteed. I know that Social Security needs to be strengthened, and I know that there has to be a way to do it that preserves that vital guarantee.

When I saw the President's State of the Union address, I was glad to hear him say *clearly* that we must protect Social Security's guarantee. We constantly hear that Social Security won't be there for people my age when we need it. Well, Mr. Chairman, it *was* there for me and I want to do my part to make sure it will be there in the future.

That is why I am here today, Mr. Chairman, to share my story and the stories of millions of other young people, like myself, who come from average families, and who have dealt with extraordinary circumstances. As the committee considers reforms to the system, I encourage you to support the core values of Social Security, and work to make the program stronger. It is a system to which we all contribute, and from which we all benefit. Guaranteed.

Chairman SHAW. Thank you, Ms. Brown.

Ms. Kramer.

STATEMENT OF LIZ KRAMER, POLICY ASSOCIATE, 2030 CENTER

Ms. KRAMER. Thank you, Mr. Chairman. My name is Liz Kramer. I am honored to be here today speaking on behalf of the 2030 Center, a public policy organization for young adults. I am 24 and I share all of your views, that we must act now to strengthen Social Security for future generations.

Mr. Chairman, my generation is a pretty skeptical bunch. A lot has been made of the fact that young people do not think Social Security is going to be there for them. You ought to be equally skeptical, however, that we can be persuaded to scrap the system and gamble on an untested alternative. Even though young people are suspicious about politicians doing the right thing, we want Social Security to be there for us, and we are looking to our Representatives in Congress to keep that promise.

Last summer, the 2030 Center conducted a national poll of 18- to 34-year-olds. Not surprisingly, we found that very few young people expect Social Security to pay them their full benefits. More importantly, however, nearly nine in ten of the young people we polled said that Social Security should pay them their full benefits. We also asked young people what they think about the viability of the current system. Very few young people think that Social Security cannot work for them the way it worked for previous generations, and needs to be replaced. On the contrary, about 70 percent of the young adults we spoke with think Social Security can work for young people when they retire if Congress will strengthen the system's finances. These numbers are strongly at odds with the picture often painted of a generation ready to scrap the Social Security system.

Let me provide a few reasons why I think that Social Security is so important to young adults. First and foremost, Social Security is important to us because we love our grandparents, and we see how important Social Security has been to our families. We are glad that fewer of our grandparents are consigned to poverty than in the past. We want our parents to have that same financial security.

However, Social Security is not just for our grandparents. Nearly one-third of all Social Security beneficiaries are not retired. As Tyra Brown has just illustrated, Social Security provides crucial benefits for young people who have lost a parent or whose parent has become disabled. As we get older, these benefits protect our spouses and our children. Social Security has been incredibly successful in ensuring that young people who have had life-changing tragedies have a way to get back on track.

Social Security is also important for young people because it offers some financial security in a rapidly changing economy. While our parents were able to rely on pensions, along with their savings and Social Security, we face a very different situation. Mr. Chairman, pensions are disappearing for people my age. Pension coverage for young workers aged 24 or less has fallen by one-third since 1972, according to the Department of Labor. Less than half of all workers under the age of 30 have any pension at all. In addition, wages have been declining for young people since the early seventies, offering less opportunity to save.

The jobs of the future do not seem to promise any improvement. For example, the government projects that the occupation with the most growth in the next decade will not be web designers or investment bankers, but retail cashiers. I can tell you that my friends who ring up your books or your clothes do not have good pensions and do not have high wages. These workers cannot afford to have their only guaranteed retirement income cut out from under them. That is why Congress should focus on strengthening, and not replacing, the Social Security Program.

Now I recognize that Social Security needs some adjustment. In considering proposals to do that, I urge Members of this Subcommittee not to jeopardize the aspects of the program that are critical for young people. We want our benefits guaranteed. We want provisions if we become disabled. We want our children to be provided for if we should die young. We want adequate benefit levels so that old age is not synonymous with poverty. We want the checks to keep coming, even if we should live to see our 100th birthday.

President Clinton has put forward a proposal that can maintain these important benefits, and I applaud that. On the other hand, proposals to privatize Social Security can not meet these important needs for younger generations. Not only do privatization plans cut our benefits and increase the age at which we could retire, but they also saddle us with the burden of a huge transition cost.

America can do better than that. In a time of record economic growth, with surpluses building by the day, I ask Congress to safeguard my generation's economic future. Now is not the time to jeopardize our economic security with a risky and costly imitation of Social Security. Now is the time to strengthen Social Security for my generation and for the generations to come.

Thank you.

[The prepared statement follows:]

Statement of Liz Kramer, Policy Associate, 2030 Center

Thank you, Mr. Chairman. My name is Liz Kramer, and I am here today speaking on behalf of the 2030 Center, a public policy organization for young adults. I am 24, and I share your view that we must act now to strengthen Social Security for future generations.

Mr. Chairman, my generation is a pretty skeptical bunch. A lot has been made of the fact that young people do not think that Social Security is going to be there for them. You ought to be equally skeptical, however, that we can be persuaded to scrap the system and gamble on an untested alternative.

Even though young people are suspicious about politicians doing the right thing, we want Social Security to be there for us, and we are looking to our representatives in Congress to keep that promise.

Last summer, the 2030 Center conducted a national poll of 18–34 year olds. Not surprisingly, we found that very few young people expect Social Security to pay them full benefits. More importantly, however, nearly nine in ten say that Social Security should pay them full benefits.

We also asked young adults what they think about the viability of the current system. Very few young people, we learned, think that Social Security "cannot work for them the way it worked for previous generations, and needs to be replaced." On the contrary, about seventy percent of young adults think Social Security "can work for young people when they retire if Congress will strengthen the system's finances."

These numbers are strongly at odds with the picture often painted of young people ready to scrap the Social Security system. Let me provide a few reasons why I think that Social Security is so important to young adults.

First and foremost, Social Security is important to us because we love our grandparents, and we see how important Social Security has been to our families. We are glad that fewer of our grandparents are consigned to poverty than in the past. And we want our parents to have that same financial security.

Social Security, however, is not just for our grandparents. Nearly one third of all Social Security beneficiaries are not retired. Social Security provides crucial benefits for young people who have lost a parent, or whose parent has become disabled. As we get older, these benefits protect our spouses and our children. Social Security has been incredibly successful in ensuring that young people who have had life-changing tragedies have a way to get back on track.

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In addition, wages have been declining for young people since the early 70s, offering less opportunity to save.

The jobs of the future do not seem to promise any improvement. For example, the government projects that the occupation with the most growth in the next decade will not be web-designers or investment bankers, but retail cashiers. I can tell you, my friends who ring up your books and your clothes do not have good pensions or high wages.

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President Clinton has put forward a proposal that can maintain these important benefits, and I applaud that. On the other hand, proposals such as privatization cannot meet these important needs for younger generations. Not only do privatization plans cut our benefits and increase the age at which we can retire, but also they saddle us with the burden of a huge transition cost.

America can do better than that. In a time of record economic growth, with surpluses building by the day, we ask Congress to address our economic future by bolstering the Trust Funds. Now is not the time to jeopardize our economic security with a risky and costly imitation of Social Security. Now is the time to strengthen Social Security for our generation and for generations to come.

Thank you.

AMERICANS VIEW SOCIAL SECURITY REFORM

FACTSHEET

For years, pollsters have been measuring public reaction to a simple proposition: “allow individuals to invest a portion of their payroll taxes for retirement.” Most people say “yes” to the offer.

Pollsters also have been measuring public confidence in the future of Social Security. Historically, confidence declines the more Social Security is discussed in public debate. Today, public confidence is low—particularly for younger workers.

While the lack of confidence means, more often than not, “fix Social Security,” the public’s favorable initial response to “individual accounts” must be taken seriously. We have long believed, however, that these measures described above are extremely shallow and unreliable for policy makers.

In order meaningfully to evaluate support for policy alternatives such as privatization, respondents must also be provided with information about the trade-offs of diverting revenues from Social Security in order to fund individual accounts—namely, steep reductions in guaranteed benefits.

In our groundbreaking research project, we have taken this step forward in order to provide a more rigorous analysis and move debate down a more responsible path.

Among the key findings from our research:

• Americans want Social Security to be there for them. Though only 20 percent of Americans expect to receive benefits at current levels when they reach retirement, fully 90 percent say that the system should pay them such benefits.

• Americans believe in Social Security. Fully 73 percent say that Social Security "can work for young people when they retire if Congress will strengthen the system's finances," while only 24 percent say that "the Social Security system cannot work for young people the way it worked for previous generations, and it needs to be replaced."

• Younger and older Americans share similar views on Social Security reform. The poll included an oversample of young adults age 18–34. The survey shows no significant differences in opinion across generations, except for a more marked lack of confidence among younger generations. Both younger and older Americans agree that Social Security should be strengthened and agree on major reform proposals.

• Americans oppose benefit cuts more than they support individual accounts. Americans are initially attracted to the idea of individual retirement accounts, but reject privatization when they consider the benefit cuts necessary to enact even "modest" privatization plans.

We tested a privatization plan originally proposed by the National Commission on Retirement Policy, called the 21st Century Retirement Act, and introduced in the House by Representatives Kolbe and Stenholm as H.R. 4256, and in the Senate by Senators Gregg and Breaux as S. 2313. (Not surprisingly, the sponsors have mounted an aggressive and groundless attack on our poll.)

In addition to providing workers about one-sixth (two percentage points) of their payroll taxes to invest for their retirement, the 21st Century Retirement plan included a series of benefit reductions (required by the individual account "carve-out").

In isolation, key elements of the 21st Century approach are overwhelming rejected:

• 78 % oppose raising the retirement age to 70 (as reported in the New York Times; the 21st Century plan would, in fact, raise it to 72.5 eventually);

• 87 % oppose reducing the average guaranteed monthly benefits for future retirees by about 30% (the reduction was calculated by the Congressional Research Service);

• 63 % oppose reducing the annual cost-of living increase below inflation (their plan would reduce the COLA below the anticipated BLS changes to the CPI).

When presented as a package that includes the individual account as well as the trade-offs—only 31 percent support the 21st Century privatization approach. "Strong opposition"—which I think you will agree is a critical element of any political battle—also rises sharply when the full 21st Century plan is considered.

• Americans support a plan that would maintain benefits by investing the Trust Fund like a private pension and raising the payroll tax "cap." This proposal is both supported more, and generates less opposition than, privatization plans. It is important to keep in mind that the reason this plan generates support (we find 58 percent support) probably is that it does not include significant benefit cuts—different approaches to solvency with the same result would likely be supported just as much or perhaps more.

The American people, the poll finds, favor the concept of individual accounts most strongly when it is posed as a voluntary add-on to Social Security—not as a mandatory carve-out.

This is a Peter Hart Research Associates national survey. The survey was conducted by telephone from July 6 to 13, 1998, among a national sample of 1,090 adults, including an oversample of young adults age 18 to 34. See the full poll and report at www.2030.org or call the 2030 Center at 202–822–6526.

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Chairman SHAW. Thank you.

Mr. Hulshof, do you have any questions?

Mr. HULSHOF. I do. Thank you, Mr. Chairman.

Ms. Kramer, let me, first of all, start by saying that just as your generation—and I'm paraphrasing your testimony—just as your generation is a pretty skeptical bunch, there are those of us on this Subcommittee that are also fairly skeptical when it comes to scrapping the present system. I think everybody on either side of the dais here agrees that Social Security has been a very successful program.

But a couple of things I wanted to ask you about in particular on the second page of your testimony regarding things that your group wants. One of those things you list is adequate benefit levels. I thought I read recently that a worker your age, and you mentioned you are 24 years of age, that as you join the work force, that you would have to live to about 90 to 91 years of age before you actually get out of the Social Security system what you actually pay into it. Is that what you mean when you say that you want adequate benefit levels? Or is there a way that we can maybe make that a little more fairer, so that you can maybe get more out of the system than what you are putting in?

Ms. KRAMER. When I mentioned adequate benefit levels I mean keeping benefits at around the same level they are today, and keeping them up with the cost of living. I think that providing a guaranteed benefit is much more important than looking at the exact amount that's returned.

Mr. HULSHOF. I would like to ask Mr. Anderson, Jr., a question. You mentioned that in your earlier years that you used to be punished by watching or having to watch, was it MSNBC?

Mr. ANDERSON, JR. CNBC.

Mr. HULSHOF. What is it that pop makes you watch now to punish you?

Mr. ANDERSON, JR. Well, I still watch CNBC, but sometimes I can watch cartoons. But when I get home, with my father I'll watch CNBC for the rest of the day.

Mr. HULSHOF. A more serious question for you. How did you learn or was it difficult to learn how the stock market worked?

Mr. ANDERSON, JR. No, it wasn't that difficult.

Mr. HULSHOF. What about some of your classmates? I suspect that you have a unique knowledge about the stock market that other students your age—what do you tell your classmates or playmates? Do they ask you questions? Do they ask for stock tips? Do they show an interest as you show an interest in the stock market?

Mr. ANDERSON, JR. No.

Mr. HULSHOF. You said that you wanted to start your own investment company someday. Is that right?

Mr. ANDERSON, JR. No. It's one day I plan to have my own Richard's Kids Industrial Average, with 30 blue chip stocks.

Mr. HULSHOF. I see. Let me ask a question of Mr. Anderson, Sr. How is it that your son has shown such a propensity? Was it extra guidance from you or is it just something he picked up on his own?

Mr. ANDERSON, SR. Introduction at an early age. If we expose our children at a very early age, you will be surprised. They will make us proud. I just happened to expose Richard to the New York Stock Exchange and stock markets and mutual funds and those things. The same thing I think probably would have happened if I would have exposed him to scientific things or art, or any of those things. I think if you introduce the children at an early age to any discipline, they won't be frightened by it; they won't be afraid of it. We introduce our children to a lot of things. They watch a lot of cartoons. Sometimes I think that if we have a balance, they will just surprise us, as Richard continues to surprise me.

You know, people will talk about how is it that—it must be a lot of work working with a child who is gifted. The first thing I say is that, you know, my son has been exposed at any early age. Any child that is exposed at an early age will be able to do the same things that Richard is doing. The financial world is a language. If they learn it at an early age, they will understand it. They will make it their own. We have that opportunity.

I think that, again, in our public education system there is a lot of concern, obviously, reading, writing, arithmetic, public speaking, but because of longevity, just think—I mean, who would have ever thought that people 1 day might routinely live to 110 or 120 years old? That has changed the dynamics of how we should look at education, and what should be part of the core curriculum forever. We know that, but it is important that our children understand money management as quickly as possible.

The Social Security system was a very nice system when we didn't have that many people receiving benefits and we had so many people paying into the program. But as we know now, we are going to have a lot of people living for a very long time. We are going to have less people paying into the program. We are going to have to do something. Part of that, obviously, is that all of us will have to make a conscious effort to make sure people, young people especially, understand at the earliest possible age that they are going to be responsible for most of their financial future.

Mr. HULSHOF. Thank you, Mr. Chairman.

Chairman SHAW.

Mr. Matsui.

Mr. MATSUI. Thank you very much, Mr. Chairman.

Mr. Anderson, I want to ask you, Mr. Anderson, Sr. And by the way, I want to thank Ms. Kramer and Ms. Brown and Mr. Anderson, Jr. I have read your testimony and I have heard your testimony. I am not quite sure what you are trying to say. I know you want individual investments, but are you saying take the 12.4 percent, half out of the individual, half out of payroll, and let the individual do what he or she needs to do in terms of investing? What is your proposal?

Mr. ANDERSON, SR. Let me start with this premise. Some of us in——

Mr. MATSUI. I just want to know what your proposal is, so I can get a better understanding of it.

Mr. ANDERSON, SR. My proposal is that part of the current money paid into Social Security should remain with the individual for self-directed investment.

Mr. MATSUI. If I may just ask, what percentage? What are we talking about? Your 12.4? Or do you have—maybe you are talking more generically. Is that what it is?

Mr. ANDERSON, SR. Yes, generically. I am not sure of the percentage.

Mr. MATSUI. OK.

Mr. ANDERSON, SR. But what I am quite sure of is I personally don't think that we should pass that off to the government.

Mr. MATSUI. No, I understand. I understand that problem. I just want to know what your proposal is. We are in agreement about the need to make some major adjustments to the system because of the demographic changes going on in the country. I just want to know what your proposal is.

So you are here today basically to say generically you think that the individual worker should have the right to invest part of that 12.4 percent?

Mr. ANDERSON, SR. Yes.

Mr. MATSUI. But you haven't defined what percentage that might be?

Mr. ANDERSON, SR. Not at all. Not at all. I mean it could be, I mean just to throw out an arbitrary number, it would be 50 percent.

Mr. MATSUI. Fifty percent. Now let me ask you, assuming that one-third of all benefits paid or demographically we're assuming in the future will be on disability payments and survivor's benefits, one-third of all benefits paid, now what do you want to do with that? I want to know how you would handle Ms. Brown and her situation. Which I want to tell you, Ms. Brown, I really have a great deal of admiration and respect for you because you have gone through tragedy, obviously, losing your mother at a very early age, somebody who sounds like a very wonderful person, and being where you are today and the enthusiasm you have. I just want to thank you for your testimony as well as all the other witnesses that have testified, because I think you are going to be somebody that is going to make it big in the future. If you are ever looking for a job, there's a few of us that may be interested in you.

But perhaps you, Mr. Anderson, could give us a little hand here. How would you propose to deal with—because that's a big part of Social Security, disability payments and, obviously, survivor's benefits. How do you propose to deal with that?

Mr. ANDERSON, SR. Let me say that is a—you know, obviously, that is a very complicated issue.

Mr. MATSUI. It's not too complicated. It's just that these payments are paid out out of the Social Security Trust Fund. I just want to know how you would deal with it, because there's a lot of folks that are in that situation and may not have the savings that perhaps you have for your son, should that misfortune fall on your family.

Mr. ANDERSON, SR. Let me say I am not arguing that we do away with Social Security altogether, not at all. I mean there are certain parts of Social Security that——

Mr. MATSUI. Do you think there should be a safety net for people?

Mr. ANDERSON, SR. Oh, absolutely.

Mr. MATSUI. And do you think it should be defined so everybody kind of has an understanding of what that safety net really is? I mean——

Mr. ANDERSON, SR. There should be a safety net in regard to those, certainly in regard to disability and some of the other programs within Social Security. I think what I am trying to say in regard to the retirement issue, those benefits that are paid out strictly for retirement, that based on the current returns on some of that money, we're just not going to be able to meet the retirement needs of young people in the future.

Mr. MATSUI. We understand that. We understand that. Everybody is in agreement that there is a problem that has to be dealt with. I agree with you on that. I am just trying to find a way to do it. I need from you something a little more specific. You are here as a witness before the U.S. Congress. Two weeks ago we had Jesse Jackson and Jack Kemp. They didn't add a lot to the debate. Now we have you and your son and two others. We have got to get into the meat of this issue. We are running out of time. We just can't have this really kind of good feelings about this stuff here. We know what the problem is. But now we need solutions so we can start negotiating.

The President has come out with his proposal. Now do you think because you are in the investment banking business, do you think that reducing the $3.7 trillion Federal debt is important? Does that help unleash private sector investments in capital investment? Is that a good idea? Of course it is, right? I mean you know that.

Mr. ANDERSON, SR. I mean, obviously, if you reduce the debt, it works out across the board, hopefully.

Mr. MATSUI. Don't you think though that reducing that debt from $3.7 trillion to $1.2 trillion is a good idea over the next 15 or 20 years?

Mr. ANDERSON, SR. Absolutely. Absolutely.

Mr. MATSUI. You think that's important?

Mr. ANDERSON, SR. It is important.

Mr. MATSUI. Because what does that do? That helps the economy by unleashing money into the economy for private sector investment.

Mr. ANDERSON, SR. It certainly does.

Mr. MATSUI. OK. Well, thank you. I appreciate your testimony. I appreciate everybody's testimony today.

Chairman SHAW. I might say to Mr. Anderson that Mr. Greenspan agrees with you in regard to that.

Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman. I'll be brief.

Mr. Anderson, Sr., I just want to compliment you on being able to make your son watch CNBC when he was punished. I have got a 5-year-old and a 3-year-old. I could sit them in front of the television and turn it on, but I couldn't make them watch it I don't think. So you have my compliments. Maybe I could talk to you later about a method to get them to do what I say when I am punishing them like that.

I have enjoyed the testimony of everybody. While it's true that no specifics were given by any of the witnesses with respect to how we solve the long-term problems, keep a guaranteed benefit, and keep the disability portion and the survivor's portion and all those things, I think it is refreshing to know that there are people, young and very young, who are concerned about the Social Security system and want to see us make a responsible effort to ensure that it's there for future generations.

So unlike Mr. Matsui, I want to thank all of you for adding to the debate and making sure that we old guys up here in Congress understand that it is an imperative to do something now for the survival of Social Security. So thank you for your testimony.

Mr. MATSUI. If the gentleman, since he mentioned my name, would just yield?

Mr. MCCRERY. I would be glad to yield.

Mr. MATSUI. I appreciated their testimony. I think I thanked everybody about three or four times. I just want to get into some of the meat. We need to know pretty soon, if the gentleman will just let me complete——

Mr. MCCRERY. If I may reclaim my time, we'll have plenty of time with other witnesses to get into the specifics. The next panel, for example, probably has some more specific ideas. But I appreciate these witnesses.

Mr. MATSUI. I am just waiting for the President to come up with his—I mean the President has come up——

Mr. MCCRERY. Yes. I am waiting for the President, too, to come with some specifics.

Mr. MATSUI. I am waiting for you to come up with your proposal now.

Mr. MCCRERY. The President has given us very few specifics, which is part of the problem. So I wish that you would urge the President to do just that, just as you have urged these witnesses that were kind enough to come and spend some time with us today.

Chairman SHAW. I would like to remind my Ranking Member that we have given very wide latitude on invitations by the Minority. Two of the members of this panel have been invited by the Minority.

Mr. MATSUI. As I said to the gentleman, we appreciate their testimony. It's just that eventually we are going to have to start making some decisions. The President has come up with this proposal. We need now to hear from you folks.

Mr. MCCRERY. The President's proposal is just to dump more money into it.

Mr. MATSUI. Well, I hope you come up with something then that has a little pain. Then we can start talking about that, Mr. McCrery.

Chairman SHAW. I would suggest that I believe that this President is going to come up with something a little more definitive than what we have gotten. I look forward to working with him.

Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman. Thank all of you for being here.

Ms. Kramer, I wanted to just ask you a couple questions. First, I think your testimony and the work of 2030 really does demonstrate the fallacy of the myth that young people of your generation don't care about seniors and don't care about Social Security. The polling data you have certainly demonstrate how wrong this notion is that young people are too selfish to care about the rest of society and that everybody ought to just have to fend for themselves, instead of a meaningful retirement security program that's available to the least in terms of economic capability in our society to retire with dignity. So, I appreciate your presentation, and thought you perhaps might want to comment if 2030 and you have developed any position on the specifics of what President Clinton has set forth in his State of the Union Address concerning the future of Social Security and the best approach for addressing the problems that we face.

Ms. KRAMER. Yes. We have thought about the President's proposal and have talked since the State of the Union. We are very happy to see that he did not propose to raise taxes. Nor did he propose benefit cuts. But he came up with a very fiscally sound proposal to ensure that the great majority of our budget surplus goes to strengthen the Social Security system.

We like the idea of the USA accounts being totally on top of and separate from Social Security, so that we can maintain the integrity of the program and encourage savings through different avenues.

Mr. DOGGETT. Thank you. I yield back.

Chairman SHAW. The gentleman from California.

Mr. BECERRA. Thank you, Mr. Chairman. In fact, Mr. Chairman, let me first thank you for letting me participate since I am not an official Member of the Subcommittee. I do appreciate that you allow me to take a few minutes of the time. I won't take up the 5 minutes because I know we want to move onto the other panel as well.

Let me thank the witnesses for their testimony; I appreciate their comments.

If I could ask first Ms. Kramer, because I know that folks at 2030 Center have done a lot of work on this issue. Is it your sense that the younger generation, the Generation Xers, as they are called, have this embedded belief that Social Security will not be there, or is it one of those things that if off the cuff they are asked the question what's more likely, the Martians to be on Earth or Social Security to survive, that it's more a quick reaction? Do you sense that younger folks really believe that Social Security is not available or will not be available for them into the future?

Ms. KRAMER. My sense is that younger people in general are losing faith in government, and that it is much broader than just Social Security. So, yes, when you ask them, do they believe more in UFOs or do they believe that they will get their full Social Security benefits, they are likely to tell you that it's more about UFOs.

But like I tried to emphasize in my testimony, it doesn't mean that they don't want Social Security to be there for them. They think these programs have been very successful, Social Security and Medicare, and they want them to remain there. They are just concerned about the whole political process and what can come out of that.

Mr. BECERRA. If I could ask Mr. Anderson, Sr., a question. Perhaps Mr. Anderson, Jr., as well can respond. I think one of the things that Mr. Matsui was beginning to ask you, I'm not sure if you were able to really get into it too much, was the question of the current Social Security contributions that are made by employees that totals 12.4 percent, the contribution by the employee and equal contribution by the employer.

If you were to take some of that money and use it to construct these private accounts where individuals can invest privately, you would have a gap. The 12.4-percent contribution to Social Security would now be less, whatever percentage you decide it would be. If a good portion of that—and Mr. Matsui mentioned that a third of it—of the Social Security dollars that we expend every year, goes to things like disabled or survivors of a Social Security recipient who has expired, how would you make up the difference? If you knew that the sum to make up the difference were in the trillions, do you have any suggestions on where we would try to seek the moneys to either fill the gap, or would we just reduce the benefits either to surviving spouses and children or to the disabled, or just cut across the board for recipients of Social Security?

Mr. ANDERSON, SR. First, I don't propose that we reduce for those who in fact are in need in those programs that you just mentioned. Not at all. But I think that in regard to the dollars that are provided solely for retirement, not the need dollars. We're talking about solely for retirement. I believe that there is a better way to get at that, and where there will be some savings from that. I am not sure exactly what the numbers are, but currently if we look at the returns on the money that is being paid into Social Security, it's very low.

Mr. BECERRA. Are you supportive of the idea of creating these private accounts that each individual would have without undermining any of the contributions currently made into the Social Security now, but still allow people to hold these private accounts?

Mr. ANDERSON, SR. Oh, absolutely. Absolutely, because, obviously, we can get a better return.

Mr. BECERRA. Are you familiar with the proposal the President came out with, what he is calling his USA, universal savings account?

Mr. ANDERSON, JR. Yes.

Mr. ANDERSON, SR. Let me say this, though: I mean, obviously, some might argue that I might have an interest in self-directed accounts, so to speak, versus the government investing the money themselves. But I think I just find some difficulty in trying to figure out like what companies would the government invest in? I have a hard time trying to figure that out.

Mr. BECERRA. Remember, this isn't the money that the government would collectively invest for Social Security. It would be your own individual account. The universal savings account would be money you have in your pocket.

Mr. ANDERSON, SR. OK. OK, I'm sorry.

Mr. BECERRA. I promised the Chairman I would not use the entire 5 minutes of my time, so I want to keep to that. So I want to go ahead and yield back the time.

Mr. ANDERSON, SR. OK.

Mr. BECERRA. But thank you very much, all of you, for your comments.

Chairman SHAW. Thank you.

Ms. Kramer, I wanted to ask you a couple of questions. I have done some quick math, which may be wrong. I believe you said you were 24 years old.

Ms. KRAMER. Congressman, can I ask you to speak up? I am deaf in one ear. I am having a hard time.

Chairman SHAW. I'm sorry. I did some quick math here. I think if I remember your testimony correctly and my math is correct, by the time young Richard retires, at that time if the retirement age were 67, I believe you would be 84 years old. He would be paying

30 to 45 cents out of every dollar that he made in his final years of employment simply to maintain the benefits for your generation. I think all of us up here on the panel, or at least most of us, will be long gone and forgotten by the time that happens. But we cannot afford to allow that to happen. If we don't do something within the next year or so, the longer we wait, the tougher it is going to get.

Now in questioning, I think by Mr. Doggett, you answered with regard to the President's plan, you mentioned the question of commitment of the surplus and not raising the taxes, but then not decreasing any of the benefits. You did not, however, comment on the question of investment of some of the surplus into the stock market, into equities. Do you have an opinion on that?

Ms. KRAMER. Surely. I'm trying to think back to what you said in the beginning. I think that when you were talking about——

Chairman SHAW. My question is only as to Federal investment into the stock market. That is my question.

Ms. KRAMER. But you prefaced by saying that when I am 86 and Richard retires that——

Chairman SHAW. I am not holding you to the math.

Ms. KRAMER. It could be up to 30 percent. I would just like to say, obviously, we want to find ways to strengthen Social Security without just increasing taxes.

Chairman SHAW. That is what we all want.

Ms. KRAMER. So the investment of a small part of the trust fund, finding a way to invest it like a pension, I think that that's an idea that is very worth looking into. I think there's a lot of responsible models for how to invest a large portion of money like that, like a pension, have it be very independent from Congress, from decisionmakers, and that that's a great way to start looking at increasing the revenue without having to simply increase taxes.

Chairman SHAW. Now the reason you would favor that, I suppose, is because there would continue to be Federal guarantees of the payments, even if the stock market went down and the surplus should be somewhat decreased because of the fluctuation of the stock market. Is that correct?

Ms. KRAMER. I wouldn't say that's the reason why I support it, but I do think that there should continue to be guaranteed benefits. I mean I think that——

Chairman SHAW. I am not committing the Subcommittee and any of the Members up here, including myself, to any particular program. But there has been a great deal of discussion with regard to individual savings accounts by the wage earner as opposed to direct investment by the Federal Government. The point has been made that they wanted to keep the politics out of it. We don't want to get into a situation where the Federal Government is giving the stamp of approval of some stocks and yet not on others. The critics of the individual investments program, however, are concerned about the fluctuation of the markets and what happens to somebody that retires when the markets are low. Those are things that are genuine considerations.

Would your thought with regard to them be any different if the Congress were to put into the law particular guarantees as to the return? So that a downward turn in the market would not necessarily be prejudicial to the wage earner who happens to reach the retirement in a down market? Have I made myself clear?

Ms. KRAMER. Yes. I think I have some idea of what proposal you are referring to. I have seen a proposal that includes ideas like that.

I think the main concept here is we want to maintain the integrity of the program. Any time you are replacing some of what we now consider Social Security with these individual accounts that do rely on the stock market, we are going to have problems. Are we going to take our whole budget surplus from now until eternity? I think it sounds like a risky program, and I want to maintain Social Security.

Chairman SHAW. Well, how do you distinguish that from the Federal Government investing? Are we smarter than other investors that would be out there? How do you distinguish that? That's what I want to know. As long as you had some guarantee of returns, I am having difficulty seeing why it's safer for the Federal Government to invest it than individual retirement accounts, which are set up with very specific restrictions and guaranteed by the Federal Government.

Ms. KRAMER. The Federal Government has a lot more money than an individual investor, right? So if I invest my own money, and when I retire all of a sudden the stock market is down, it's just my loss. But the government has a huge amount of money to invest, where it can weather the ebbs and flows of the market, I think, much better.

Chairman SHAW. But if these investments were required to be made into these giant pools, large pools, such as index funds, would you have any problem with that?

Ms. KRAMER. I would. I don't want to see the Social Security system replaced with a system that relies on the ups and downs of the market, and puts individuals at risk.

Chairman SHAW. OK. Whether the Federal Government invests it or whether the individuals invest it, it is still going to have the ups and downs, and this is something that's got to be of concern to those of us charged with drafting the legislation.

Ms. Brown, I was very much impressed with your testimony, particularly your phrase that you used in the first sentence. That is, you refer to it as "our" Social Security system, meaning that your generation, you generally look at a senior that says that. I think that that is very commendable.

I want to thank this panel.

Mr. CARDIN. Mr. Chairman, could I just make a brief comment?

Chairman SHAW. Oh, Ben, I'm sorry. I'll recognize you. You weren't here.

Mr. CARDIN. I wasn't here. I just came back. Let me thank you.

I just really wanted to make an observation to the panel as a result of your inquiries. That is, it is very helpful to us to hear from younger people as to how you view the Social Security system of the future. I just wanted to applaud our Chairman for starting the hearings of our Subcommittee with the people who are going to be most impacted by the changes that we make or how we deal with Social Security.

It is interesting that if I have a townhall meeting in my district, it is mainly seniors who come and listen to Social Security, when it is the younger generation that is going to be most impacted.

Ms. Kramer, I was very impressed by your observations. It is clear to me that the best thing that we can do for young people today is to pay down the debt. Under one of the President's suggestions, by transferring the surplus into the Social Security Trust Fund, we are going to be reducing the amount of public debt held by the private sector. This is the best thing that we can do for young Mr. Anderson here when he retires, is to have less debt outstanding.

The second thing, I think this was the point that you were making, Mr. Chairman, is that Social Security is supposed to be part of your income security when you retire. All of you have retirement options now available through your employment that we did not have when we entered the work force 30 or 40 years ago. One of the suggestions that is being made as a friendly suggestion is to make it easier for individuals to put more away for their retirement. I think that is a win-win situation if we also shore up Social Security at the same time.

So I don't think we should be looking at it as a hostile situation, whether you have to have accounts. It can be in a way that we strengthen Social Security, strengthen private retirement and reduce the debt. Then I think young Mr. Anderson is going to be in the best possible position when he retires. I think that is how we are trying to put this together, the President and the framework that he laid out for Social Security.

Thank you, Mr. Chairman.

Chairman SHAW. Thank you for your contribution.

I want to thank the entire panel for being here. I think that you have certainly spoken well, and have added quite a bit to the discussion that will be ongoing for another couple of months for sure. Thank you very much.

I would like to invite the second panel to the witness table. We have Dr. J.D. Foster, who is executive director and chief economist of the Tax Foundation. Dr. Henry Aaron, who is a senior fellow, Economics Studies Program at the Brookings Institution, and C. Eugene Steuerle. I hope I am pronouncing that correct, Dr. Steuerle, who is a senior fellow at the Urban Institute.

Mr. Anderson, you made history today. Congratulations. Thanks for being with us.

Mr. ANDERSON, JR. Thank you.

Chairman SHAW. Gentlemen, we have each of your written statements, which will be made a part of the record. We would invite you to summarize as you see fit.

Dr. Foster.

STATEMENT OF J.D. FOSTER, PH.D., EXECUTIVE DIRECTOR AND CHIEF ECONOMIST, TAX FOUNDATION

Mr. FOSTER. Thank you, Mr. Chairman. I am J.D. Foster, the executive director and chief economist of the Tax Foundation. Mr. Chairman, I offer the following prediction: Some years from now, after Social Security reform has been enacted, the kinks have been worked out, and the American people have come to understand it, we are going to have one question on our mind above all others: What took us so long? Once we understand its consequences for our children and for America's workers, we must ask ourselves why it took us so long to get to this point where we are discussing Social Security reform.

Even if the system were actuarially sound, reform along the lines, what I call personalization, would still be the right thing to do. Of course we are at this point, not because personalization itself is the right thing to do, but because the trust fund will run dry—rather soon, actuarially speaking.

Now some will tell you all you have to do is raise taxes. Now that's a fine solution. The only trouble is that it punishes today's children, tomorrow's workers. Some will tell you just keep taxes high and subsidize the system with income taxes. Such a system will forestall the fiscal calamity, but it keeps taxes high. If that is the only way to do it, well, so be it. But there is a better way. Let people keep some of their own payroll taxes. That is the basic choice we face: big government as Big Brother or individual ownership, individual liberty. The question is, where do you put your faith?

Troubled trust funds is one reason for reform. A second reason is that Social Security's pension aspect yields retirees a terrible rate of return when compared to the returns available in the private marketplace. Of course, there are no guarantees these historical returns will persist into the future, but the historical evidence is strong enough, the future is bright enough, that the burden of proof, I believe, should clearly fall on those who believe the returns will not persist.

Another reason for reform is that the payroll tax has crowded out the ability of many Americans to save for retirement in any other way. Let me just give you some numbers. These are intended to be suggestive. Consider a family, two parents, a child, total wage income of $50,000. That family pays $3,280 in payroll taxes alone. That's the individual portion, not the individual and employer. As detailed in my written testimony, the family's total tax burden could well exceed $11,000.

After taxes, then, the family has about $3,200 a month of disposable income. So let's see how they might allocate these funds. Housing costs, including utilities, may be $700. A car payment, $400. At $15-a-day per person, you are talking about $1,350 in food expenses. Other household expenses like clothes, gas for the car, toys and books for the child, maybe another $300 a month. Those total regular expenses, $2,700. Leaving the family with about $500 for other expenses and saving.

The family might like to save this $500, save it for retirement, pass it onto their children. But first they have to face the big items that show up every month like car insurance, car repairs, a new dishwasher, kid's braces, medical and dental deductibles, Christmas presents, and college expenses. The point is, once the family gets done paying its taxes and paying its bills, there isn't a lot of money left to save.

If you look at the family's tax cost, the number that has to jump out at you is the payroll tax, that $3,280. In effect, the forced contributions of the payroll tax are crowding out the private saving the family might otherwise achieve. Since Social Security effectively precludes the family from saving adequately on its own, it must yield a good return, which it does not, and it must be assured, which it is not.

Finally, reform offers America's workers a bigger piece of our bright future. Our companies are among the most competitive in the world. Our institutions are strong. Our economy is a veritable job machine. This means over the coming years, investors are going to receive hundreds of billions of dollars in interest, dividends, and capital gains. Who are these lucky people? They are the savers and the inheritors. Anyone can get a piece of this action by saving and investing prudently. But if you don't save and you don't inherit a chunk of capital from Aunt Bessie's estate, you are left out of the money.

Unfortunately, America's workers don't get much of this new wealth. Their saving is crowded out by taxes, as I mentioned. Without saving, they have no claim on this economic future. Under real reform, some portion of the current payroll tax would be divided, directed into personal security accounts, or PSAs, at a bank or brokerage house. Individuals would invest their money in real assets like corporate bonds and equities.

Giving individuals ownership and control of their retirement income is frightening to some analysts and some individuals. Some analysts just don't believe people are smart enough to be entrusted with their own money. Because many Americans do, in fact, save little or nothing at all, they are themselves concerned about the safety of their investments and their ability to invest prudently.

Comprehensive reform would address these concerns. For example, PSA owners would be required to diversify their investments, and could not invest in obviously high risk and speculative investments. With such safeguards in place, suppose every wage-earner is investing in the private sector through private security accounts. What happens? Much of the hundreds of billions of dollars in interest, dividends, and capital gains our economy will produce in the coming years, that would otherwise go to the wealthy, will go to the working men and women of America. Low- and middle-income workers would get a bigger piece of the action because through saving and investing their payroll taxes, they would own much of corporate America.

In conclusion, Mr. Chairman, I believe we should have abandoned the current Social Security structure long ago. It condemns workers to an abysmally low rate of return on their contributions. These taxes are so high, particularly the payroll tax, that workers have little extra income to save and invest more wisely.

As a pension system, Social Security guarantees workers a minimum benefit, and then virtually condemns them to no better. Real reform would break these bonds. When Social Security is personalized, the American worker will see his wealth grow over time. He will see manifested in his personal security account balance the advance of his economic status, and so enjoy the dignity and security of owning wealth.

Thank you, sir.

[The prepared statement follows:]

Statement of J.D. Foster, Ph.D., Executive Director and Chief Economist, Tax Foundation

Mr. Chairman, as an economist I am professionally compelled to make a prediction. And so I offer this prediction with more than the usual amount of confidence:

> Five years from now, after Congress enacts and the President signs Social Security reform, after the kinks have been worked out and the American people have had a chance to see how it works, the question on everyone's mind will be—what took us so long?

We are now finally debating Social Security reform in earnest with the justified expectation that reform will soon happen. We are at this point because, as is now widely recognized, the Social Security Trust Fund is predicted to run dry in a time frame which actuarially speaking is rather soon. The pending exhaustion of the Trust Fund is both bad news and good news. It is bad news because of its implications for fiscal policy; it is good news because it forces action.

However, once we look at reform and see its consequences for the soundness and security of our national pension system and for the future tax burden on America's workers, we must truly ask ourselves why it took so long to consider these reforms. Even if Social Security was sound for as far as the actuaries could calculate, personalization would still be the best way to go.

True Social Security reform centers on the idea of individuals investing some portion of their payroll taxes in the private market. For many Americans, this is a novel idea. For diehard defenders of the status quo, the proposition is anathema. For millions of people in many countries, it is already working. As is now well known, Chile personalized its public pension system 18 years ago. Since then, Argentina, Colombia, Uruguay, Bolivia, Mexico, and El Salvador have followed suit in Latin America alone.

As John Goodman, President of the National Center for Policy Analysis has pointed out, "If the current trend continues, every country south of the border—-with the possible exception of Cuba—will have privatized their pension programs long before Congress can agree on how to save our own."

I think John is too pessimistic. I believe the Congress and the President, working together, can get this done in the near future. Nevertheless, it is curious that the leader of the free world, the light on the hill drawing nations to democracy, personal freedom, and the superiority of private markets, should lag so far behind in turning Americans' pensions back to Americans.

Reasons for Reform

The most common reason given for Social Security reform is that the Trust Funds are projected to run dry some time around the year 2030. In fact, the trouble will begin much sooner when payroll tax receipts begin to fall short of current benefit payments. At that time, either taxes will be raised or spending cut to prevent Social Security from driving the consolidated budget back into the deficit from which we have just recently escaped.

Of course, there are those who will tell you the Trust Fund won't be bankrupt. There are those who will tell you this is not a "crisis" and, indeed, it is a subjective matter whether to apply that term. There are those who will tell you all you need do to solve the problem is raise the payroll tax rate 2 or 4 or 6 percentage points and the problem goes away. They are correct, of course. Similarly, for that matter all we need do is cut back benefits 20 or 40 percent to match receipts.

While these are surely simple solutions and they would work, the ease with which they are offered should in no way be confused with the enormous political difficulties and implications that would ensue if we actually tried to follow them. If you believe that a big increase in the payroll tax would be acceptable, or if you believe that a big cut in benefits would be acceptable, then there really is no issue. If these "solutions" are not acceptable, then we should put away simplistic notions and get serious.

A second reason for reform, and one just as compelling, is that the pension aspect of Social Security yields retirees a terrible rate of return. Depending on one's wage history the estimates I have seen run from a minus 1 percent real return to a plus 2 percent return. When compared to long-term returns that we see in the private markets of 7 or 8 percent, this is simply unconscionable. Of course, there are no guarantees that these historical returns will persist into the future. But the historical evidence is strong enough, and the future bright enough, that the burden of proof should clearly fall on those who claim they will not.

I would like to suggest to you two additional reasons why Social Security reform is imperative. The first is that the Social Security payroll tax has crowded out the ability of many Americans to save for retirement in any other way. Let me give you a simple example.

Consider a family, two adults and one child, with total wages and salary income of $50,000. Suppose the family has no other income. Their payroll taxes will be about $3,820, not counting the employer's share. Their federal income tax after the $400 per child tax credit, and assuming they take the standard deduction, is about $4,800. In addition, they pay state and local taxes. If they live in Virginia, their state income tax will be about $1,800. Suppose their other cash taxes—sales, property, various government fees—total $500 a year. After taxes, this family has about $39,040 in disposable income. (Note that these are cash taxes and cash wages. The employer's share of the payroll taxes and the family's share of the corporate tax burden have not been included.)

Total Income	....	$50,000
Payroll Taxes	$ 3,820	
Federal Income Tax	$ 4,820	
Virginia Income Tax	$ 1,820	
Other Taxes	$ 500	
Total Taxes	....	$10,960
Disposable Income	....	$39,040

Now let's see how the family might spend this money, which totals about $3,250 a month, keeping in mind these figures are just suggestive. Housing costs, including utilities whether renting or owning, might be around $700 monthly. The family is likely to have a car payment of around $400. At $15.00 per person per day, the family's food budget for the month would be $1,350. Other household expenses, like clothes, gas for the car, an occasional dinner out with friends, books and toys for the child, etc. would be at least $300 a month. Thus, total regular monthly expenses would be about $2,950, leaving the family with about $300 for other expenses and saving.

Monthly Income	....	$3,250
Housing Costs	$ 700	
Car	$ 400	
Food	$1,350	
Other Household	$ 300	
Total Monthly expenses	....	$2,750
Remaining Monthly Income	....	$ 500

The family might like to save this amount. But first it must deal with the extraordinary items that seem to come up from time to time and yet every month, such as car insurance, life insurance, car repairs, the child's braces, medical deductibles and co-payments, dental deductibles and co-payments, Christmas presents, and college expenses. In short, once the family pays its taxes and its regular bills, there is little left for saving.

Looking at all the tax costs the family faces, clearly the largest is the federal income tax burden at $4,820. The second largest are the payroll taxes. The payroll taxes are particularly important because most of them are supposed to be funding the parents' retirement income through Social Security. In effect, the forced contributions of the payroll tax are crowding out the private saving the family might otherwise achieve. Since Social Security effectively precludes the family from saving adequately on its own, it is imperative that Social Security yield a good return, which it does not, and that it be assured, which it currently is not.

Possibly the most important reason for reforming Social Security is to ensure that America's workers get a bigger piece of America's bright future. While we have our problems, America's future is undeniably bright. Our companies are among the most competitive in the world. Our institutions are strong. Our economy is a veritable job machine that appears able to adjust to changes in world economic conditions fairly easily.

All these good omens mean that over the next 10, 20, 30, 40 years shareholders and bondholders will receive hundreds of billions of dollars in dividends, interest, and capital gains. Who are these lucky people? They are the people who have wealth—people who save or who have inherited the savings of their parents and grandparents. The wonderful thing is that anyone can get a piece of this action by saving and investing prudently. Unfortunately, if you don't save and you don't inherit a chunk of capital from Aunt Bessie's estate, you're left out of the money. In short, the wealthy will get this wealth. The old saw is true—it takes money to make money.

President Clinton recognized this when he stated in support of his Universal Savings Accounts, which would be in addition to Social Security reform, "I want every American to have a savings account and have a part of this country's wealth."

Unfortunately, as things now stand, America's workers are unlikely to reap much of this new wealth. There are two reasons for this. The first is that they cannot save a great deal on their own because their saving potential is largely crowded out by taxes, particularly Social Security taxes as described above. Without saving, they have no financial claim on this future wealth. The second reason is that their Social Security contributions are not invested in the private sector, and so their Social Security contributions have no claim on this future wealth, either.

Today's payroll tax receipts cover current benefits and the excess pays for other government spending or to buy back government debt. None of the payroll tax receipts collected today are invested in real assets to pay future benefits. Under real Social Security reform, initially two or three percentage points of the current 12.6 percent payroll tax would be directed into an account at a regulated financial service company such as a bank or brokerage house. These accounts are sometimes called "Personal Security Accounts," PSA's. Individuals would invest their PSA money in real assets like corporate equities, corporate bonds, government bonds, and money-market instruments. In effect, workers' payroll tax "contributions" would build a real pension as opposed to contributing to other government spending priorities.

By way of background, let me review just a few numbers, starting with $787 billion and $2.6 trillion. The Congressional Budget Office projects a total surplus over the next ten years of $2.6 trillion. Of that, $787 billion is in non-Social Security accounts, $1.8 trillion is in Social Security receipts. In other words, on average over the ten-year period, the federal government will receive $180 billion in payroll taxes a year over what is needed to pay benefits. Average employment over their period will be about 150 million persons. If the entire Social Security surplus is returned to the worker to invest in his or her PSA, the average worker would invest about $1,200 a year, of about $100 a month. Over a thirty-year working life, that would provide total savings of over $117,000 at an average return of 8 percent assuming a 2 percent annual administration cost. At a withdrawal rate of $20,000, this modest PSA alone would fund almost 6 years of retirement income.

Average Excess Social Security Receipts	$180 Billion
Average Workforce	150 Million
Annual PSA Investment	$1,200
Total PSA Value at Retirement @8%	$141,000
Number of Years of Retirement Funded @ $20,000/year Annual Withdrawal	10

Giving individuals ownership and control of more of their retirement income is frightening to some. Because many Americans save little or nothing at all, they are unaccustomed to the process of investing and so they are concerned about the safety of their investments and their own ability to invest prudently. Even workers who save through employer-provided pensions rely on the pension managers to make the relevant decisions.

Comprehensive Social Security reform would include a long list of safeguards to address these concerns. For example, PSA owners could not make premature withdrawals from their accounts. PSA owners would be required to diversify their investments. They would not be permitted, for example, to make investments in obviously high-risk and speculative instruments like derivatives and options, nor could they invest most of their PSA funds in any one company or industry. And the financial institutions that maintain the PSA accounts would be subject to strict regulation, similar to those on deposit taking banks today. The government may even set up a special agency to invest PSA savings held in individual accounts solely in government bonds for individuals who so desire.

For those concerned about the level of retirement benefits both current and promised, I suspect reform would leave the existing benefit structure unchanged. In effect, reform would change the source of the benefit from taxes on workers to real assets controlled by the retiree, but it would not change the level of benefits.

With these safeguards in place, suppose everyone with wage and salary income is saving and investing in the private sector through Private Security Accounts. What happens? Much of the hundreds of billions of dollars in interest, dividends, and capital gains that would otherwise have gone to the wealthy would now go to the working men and women of America. Social Security reform would transfer some of the bounty of America's future from the wealthy to workers. Low- and middle-income workers would get a bigger piece of the action, a bigger piece of America's bright future. But this would not happen through confiscation of wealth and income through high tax rates. It would happen because, through saving and investing their payroll taxes, working Americans would own more of America and would have a legitimate claim on the economic gains in America's future.

We should have abandoned the current Social Security structure long ago. The current system condemns payroll taxpayers to an abysmally low rate of return on their investment, generally far below that paid even by Treasury bonds. And, because the payroll tax is so high, particularly when added to federal and state income taxes, workers have little extra income to save and invest more wisely.

As a pension system Social Security guarantees workers a minimum benefit, and then virtually condemns them to doing no better. Real reform would break this cycle. And the more fully reform returns payroll taxes to the workers to invest on their own behalf, the more completely the cycle would be broken. When Social Security is personalized, the American worker will see his wealth grow over time. He will see manifested in his own Personal Security Account the advance of his economic status and the dignity and security of owning wealth.

Chairman SHAW. Dr. Aaron.

STATEMENT OF HENRY J. AARON, SENIOR FELLOW, BROOKINGS INSTITUTION

Mr. AARON. Thank you very much. Let me begin by saying I think there is an important lesson to be learned from the testimony of Richard Anderson, Jr., and Sr.; it is very important to start early in educating children on the importance of saving and investing. Wait until you are 40 years old to start saving, and it's really too late to be able to build an adequate nest egg by retirement without saving a larger fraction of your income than most mortal human beings are going to do.

But I think there is another lesson in his example. I was reminded of the 6-year-old and 7-year-old musical prodigies who dazzle us with their skills. It would be nice if we could infer from such performances that all 6- and 7- or even 26- and 27-year-olds could be similarly skilled and able at their craft. We recognize that prodigies are unusual. We pay money to hear them perform, but we don't dream that everybody can emulate them.

In fact, fully one-third of people age 52 to 65 have not even thought about retirement planning, according to the most recently available survey evidence—one-third of people on the eve of retirement. There may be a day in the future when people will be as skilled as Richard Anderson is. That is not the world that we yet live in.

Mr. Shaw, you stated in your opening remarks a very important truth. With the increasing numbers of retirees, the cost of supporting them is going to increase. I want to make two additional statements about that. The first is that privatizing Social Security does exactly nothing whatsoever to reduce those costs. The only way to get ready for those costs or to reduce them, aside from cutting the living standards that the elderly and the disabled will enjoy in the future, is to encourage economic growth. The only way Social Security can do that is to boost the national saving rate. Regrettably, the most recent statistics indicate household saving is currently zero.

It is against that background I think that the debate we are now seeing begin should be viewed. We face a once-in-a-generation opportunity to shape economic policy. The advent of budget surpluses that nobody, absolutely nobody, anticipated 2 years ago gives us that opportunity. I say in my statement that credit for those surpluses should be widely shared between Members of both parties in Congress and the last two presidents, Bush and Clinton. This is not a matter for partisan bragging.

We also should recognize we have been extraordinarily lucky. The booming economy has performed better than anyone expected, and the stock market certainly does seem exuberant, if not overly so.

Now listening to the State of the Union Address, it would have been easy to miss what I think is the core truth about it. The President presented a rather abstemious program to the American public. You have to be a bit of a budgetary detective because the rhetoric sounded like it was a Christmas tree, with something for almost everybody under the sun. But the fact of the matter is, that the President was saying that he thought it was inadvisable to have large tax cuts or large expenditure increases, and that the great bulk of projected surpluses should be saved. I think the goal of increasing national saving is one that most Members of Congress on both sides of the aisle would share.

He proposed to do that in three different ways, by allocating a portion of the surplus to Social Security, a portion to Medicare, and a portion to the newly created USA accounts. I believe all three elements of the program deserve your support and would help significantly with boosting national saving, thereby facilitating added investment and economic growth, and preparing us for those costs of supporting the baby boomers to which you drew attention, Mr. Shaw, and which I believe are inescapable, to support an increasing number of elderly in the population.

I think it is important that we understand the critical and stark choice we face. The President has called for what I will call a save-the-surplus approach. And there are many in both parties who are proposing what I would call the cut-taxes-and-or-boost-government-spending approach to handling that surplus. As far as national choices on economic issues are concerned, it just doesn't get more fundamental than that. I hope that Members of Congress and the administration can come to an agreement this year. If they do not, I believe that we have a prelude of what the year 2000 Presidential campaign is going to be fought around.

Thank you very much.

[The prepared statement follows:]

Statement of Henry J. Aaron,[1] Senior Fellow, Brookings Institution

The President's State of the Union Address summons the American people to a debate of enormous national significance. That address does something that State of the Union addresses do all to rarely—*it poses a once-in-a-generation choice for the nation on what should be done with the surprising and quite extraordinary budgetary windfall generated by America's booming economy and stock market*.

Let me be clear that I think credit for the achievement of these surpluses should be broadly shared. President Bush did a major part with the deficit reduction program of 1990, as did the Democratic Congress that enacted that program. *President Clinton made a major contribution* with his deficit reduction program of 1993. And *the Republican majority in Congress* deserves a large share of the credit for pushing a larger and more aggressive program of deficit reduction in 1995 than the administration initially endorsed. These efforts would have fallen short, however, had not revenues gushed forth as the American economy turned in a performance that virtually no economist, certainly none in OMB or CBO, anticipated. The achievement of unemployment rates consistently below 5 percent was a dream few dared to entertain, and the stock market now surely deserves to be described as exuberant, even if some may still feel it is not overly so. So, there is credit enough for all to share.

We are so numbed by large numbers that the significance of prospective surpluses of $4.8 trillion during the next fifteen years is hard to appreciate. Under current policy, debt in the hands of the public will fall by more than three-quarters measured as a share of GDP over the next decade. The prospect of huge surpluses for a nation whose public sector has been hemorrhaging red ink for the last quarter century is quite intoxicating. To be sure, a run of really bad economic fortune could end these hopes. But prospects are so good that a recession of less-than-major proportions is unlikely entirely to erase these surpluses.

Viewers of President Clinton's State of the Union Address may not have noticed that he presented a rather abstemious program. One has to be a bit of a budgetary detective to discover this fact, because the president seemed to portray a Christmas tree of goodies for every conceivable group. In fact, he called on the nation to save most of the budget surpluses that loom in our nation's economic future.

Virtually every elected official—Republican and Democratic—agrees that the United States should save more than it now does. And they also understand that federal budget surpluses add to national saving. Surpluses enable the federal government to buy back bonds held by the public. Those purchases, in turn, release funds for investment in buildings, equipment, and inventories. And more investment means increased economic growth.

Unfortunately, everyone also agrees that budget surpluses produce Congressional fiscal incontinence. Republicans, and not a few Democrats, ache to cut taxes. Democrats, and not a few Republicans, have lengthy lists of government spending programs they would like to fatten up. While Republican and Democratic tax cuts tend to flow into different pockets and Republican and Democratic spending priorities tend to favor different groups, the prospect of large budget surpluses has a remarkable capacity to produce coalitions large enough to both cut tax cuts and boost spending. The result, most observers fear, is that budget surpluses would evaporate and national saving would remain depressed.

The remarkable feature of the program President Clinton announced in his 1999 State of the Union Address is that it would simultaneously increase national saving, raise economic growth, and improve the financial condition of the two largest and most popular government programs, Social Security and Medicare. Here is how.

The largest component is the transfer of bonds to Social Security and Medicare, the two largest and most popular domestic programs of the federal government. This transfer would total about $3.5 billion over the next fifteen years, an amount equal to more than three-quarters of the projected unified budget surpluses.[2] Part of these transfers is a straight budgetary operation. But an additional part can be understood only as a debt transaction. The unfunded liabilities of Social Security and Medicare arose because early beneficiaries under both programs received benefits far larger than the taxes paid on their behalf could justify. Taxes levied on later workers went to support these benefits and are therefore not in the Trust Funds to support current and future benefit obligations. Unless Congress decides to walk away from those obligations—and I have not heard any member of Congress or of

[1] Senior Fellow, The Brookings Institution. The views expressed here do not necessarily represent those of the staff, officers, or trustees of The Brookings Institution.

[2] Some critics of the President's plan allege that he has engaged in double counting. I believe that this charge is bogus for reasons explained in Appendix 1 to this testimony.

the Administration propose to do so—someone must meet this unfunded liability. Under current law, the cost of paying those benefits would fall on the payroll tax (if benefits are maintained) or on future benefits (if payroll taxes are not increased).

The president proposes to deposit government bonds to defray part of this unfunded liability, thereby putting a call on future general revenues—personal and corporation income taxes—to pay for this unfunded liability. In short, his plan would distribute the cost of paying this unfunded liability more progressively than would current law. One may agree with this shift or oppose it. *But the key point, is that the cost of paying off the unfunded liability is inescapable. The question is not whether we pay it, but who pays it*.

The president's plan would take us about half way to closing the projected long-term deficit in Social Security and would extend the financial viability of Medicare hospital benefits for several years. Although benefits under neither Social Security nor Medicare are particularly generous, revenues and accumulated reserves are smaller than promised benefits.[3] The transfer of bonds now to Social Security and Medicare would offset about half of the resulting gap. A modest menu of additional steps could close the rest of the gap.

Under the president's plan, about $500 billion would go to help create new USA savings accounts for American workers and to match individual contributions to these accounts. USA accounts could be of particular value to low and moderate wage workers most of whom now save almost nothing voluntarily. In addition to providing a nest egg for retirement, such accounts could support the purchase of a first home, help pay for the college education of children, defray the costs of a major illness, or underwrite the start of a small business.

The common characteristic of all three of these measures is that they would not support current consumption. Instead, they entail saving, which will support investment today and consumption in the future.

The president's program also would allocate an amount equal to approximately 12 percent of projected budget surpluses for tax cuts or for increases in so-called "discretionary" spending of the federal government, including national defense and domestic activities. Only this piece of the program would boost current individual or collective consumption.

The contrast between the president's program and that of the "cut taxes or boost government spending" advocates could not be more stark. Poised at the portal of a new millennium, the United States government has at its disposal resources of almost unimaginable size beyond those it expected to have available. *Should the nation spend those resources now or save them?* If it saves them, should it do so in a way that will boost national production for ourselves and our children and helps support basic pensions and health care for decades? These questions are fundamental and large. *It is hard to imagine questions better suited to resolution by the electorate of a mature democracy. If not settled this year, they well merit center stage in the year 2000 presidential election.*

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Appendix 1

The Phony Issue of Double-Counting[4]

The president's budget proposal announced in his State of the Union Address has provoked a good deal of confusion about how the numbers fit together. Some people are criticizing the plan for allegedly "double counting" the Social Security surpluses. The purpose of this note is to explain how the president's proposal would work from an accounting perspective. The message is simple: the double-counting issue is bogus. The president's address outlined a bold plan that stands in striking contrast to alternative proposals that would use projected budget surpluses to justify large tax cuts or spending increases. Faced with a once-in-a-generation choice about how to spend large and unanticipated surpluses, the nation should confront the big issue "save the surplus or spend it" and not get mired in accounting pettifoggery.

My explanation is built around four tables. The first lays out the president's program in the terms he presented it. The second shows how some can treat it as double counting. The third shows the effect of the president's plan on debt obligations and debt holdings from various perspectives. The fourth recasts the president's plan

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[3] Many people allege that the Social Security Trust Funds are not real assets because they have been invested in government bonds. This position rests on fundamental confusions, as explained in Appendix 2 to this testimony

[4] Forthcoming in Tax Notes

in terms of the unified budget with an important change in budget rules and shows that the charge of double counting is based on confusion.

Initial Situation

Because I do not have access to the specific numbers in the budget forecast, I illustrate the accounting for the proposal with a hypothetical initial situation. I assume that the budget faces a projected unified budget surplus of 150, consisting of a surplus in Social Security of 100, and a surplus in other operations of government ("on-budget") of 50.

	Initial Balance
Social Security	+ 100
On-budget	+ 50
Unified Budget	+ 150

The President's Plan

To keep the numbers whole, I assume that the president proposes to allocate 90 to Social Security, 22 to Medicare, and 38 to other purposes (including tax cuts, USA accounts, defense, and non-defense discretionary programs). These amounts happen to be equal to 60 percent of the *unified budget surplus* for Social Security, approximately 15 percent for Medicare, and approximately 25 percent for other purposes. These numbers correspond approximately to the proportions the president presented in his State of the Union address. As with the president's proposal, however, the appropriations for these purposes would be stated as hard numbers, *not as fractions of the projected unified budget surplus*.

Table 1 shows the budget accounting for these transactions. Note that the term "unified budget" does not appear in table 1. I have omitted it because I believe that the budget initiative of the president implicitly adopts a budget framework, used by some but not all Republicans in 1998 to motivate tax cuts, but the president employs that framework to motivate a quite different policy. In 1998, CBO projections indicated that the unified budget would be in surplus over the succeeding decade, but that virtually all of that surplus would be accounted for by Social Security surpluses. That is, the cumulative "on budget" surplus over the succeeding decade was essentially zero. Nonetheless, the Republicans claimed that projected "surpluses" justified a tax cut.

Table 1–1: The president's plan

On-budget surplus	50	Allocation to Social Security (set at 60 percent of Balance).	90
Social Security surplus	100	Allocation to Medicare (set at 15 percent of Balance).	22
		Available for other uses (*tax cuts*, USA accounts, defense, non-defense discretionary.	38
Balance available for various uses	150	Total uses of funds	150

The president seems to be saying: "OK. If you want to treat the unified budget surplus as up for grabs, so will I. But I shall allocate it for my purposes, not yours." One should keep in mind also that the president, as well as many Republicans, have made much of their success in "balancing the budget." But this claim makes sense only if "the budget" refers to the unified budget, as the "on-budget" accounts—that is, the unified budget less Social Security—remain in deficit. To treat only projected "on-budget" surpluses as available for saving Social Security or any other purpose would mean admitting that these "on-budget" surpluses have not yet been realized.

Reconciliation

This approach has led to the charge by some budget analysts that the president is double counting the Social Security Surplus. Table 2, "reconciliation" table, indicates how one might reach this conclusion. The Social Security surplus of 100 appears twice: once by itself and once as part of the unified budget surplus. The president could well respond that it was the Republicans who began this approach by claiming that Social Security surpluses justified tax cuts, even when the "on-budget" accounts were projected in 1998 to have no surpluses until 2005. As indicated below, however, there is a more fundamental answer.

Table 1–2: Reconciliation

Sources		Uses	
Unified budget surplus	150	Additions to Social Security reserves	190
Social Security surplus	100	Additions to Medicare reserves	22
		Available for other uses	38
Total	250	Total	250

DEBT TRANSACTIONS

Table 3 shows the changes in debt and asset holdings arising from the president's proposal. It reveals that debt in the hands of the public falls by the amount of the unified budget surplus less uses of funds for purposes other than adding to Social Security and Medicare reserves, while debt obligations of the Treasury (which are subject to the debt limit) actually increase.

Table 1–3: Debt Reconciliation under President's Plan

	Public Holdings of Government Debt	Government		
		Trust Funds		Treasury Debt Obligations (subject to debt limit)
		Social Security Reserves	Medicare Reserves	
Initial Social Security Surplus (100)	− 100	+ 100		
Transfer to Medicare (22)	....	....	+ 22	+ 22
Transfer to Social Security (90)	....	+ 90	....	+ 90
On-budget surplus (50, less 38)	− 12	− 12		
Total	− 112	+ 190	+ 22	+100

This increase in debt owed by the Treasury does not correspond to an actual growth of government debt, *if one takes benefit commitments under Medicare (part A) and Social Security as given*. From this perspective, the federal government has a "shadow" debt, in addition to the official debt, equal to the difference between a) the present value of promised Medicare (part A) and Social Security benefits and b) the present value of payroll taxes expected at current rates. President Clinton's proposal replaces a part of this implicit debt with explicit government debt deposited with the Trust Funds of these two programs. The president's plan reduces the projected long-term deficit in these two programs. If the president had wished, he could have proposed closing the deficit in these two programs entirely by depositing newly created Treasury obligations in the Trust Funds—that is, he could have replaced implicit debt entirely with explicit debt. Instead, he declared that additional steps are necessary—presumably benefit cuts or tax increases—are necessary to close the projected long-term deficit entirely and invited members of Congress to join him in fashioning such changes.

A MODIFIED UNIFIED BUDGET FRAMEWORK

To see why the charge of double-counting is bogus, one need only translate the president's program into the traditional framework of the unified budget.

Under the modified unified budget rules, the transfers of bonds from the Treasury to Medicare and Social Security would count as "on-budget" outlays but not as income to either program (hence the deposits are put in parentheses in Table 4). These transfers, along with the increase in discretionary spending, fully exhaust the budget surplus. This change in rules is essential for achievement of the president's stated purpose of reserving the surplus to increase national saving. Under the old rules, the receipts to the Medicare and Social Security Trust Funds would count as receipts, leaving a unified budget surplus of 112. This sum would be available for tax cuts or increased spending, both of which would boost national consumption, not saving. And if taxes were cut or spending increased by this amount, the federal government would not repurchase any debt from the public. But it is these repurchases that free resources for investment.

Table 1–4: A Unified Budget Accounting of the President's Program

"On-budget" Accounts — initial situation	+ 50	
New discretionary spending	− 38	
Transfers to....		
Social Security	− 90	
Medicare	− 22	
Medicare — transfers from Treasury	....	(+ 22)
Subtotal — On-budget	− 100	
Social Security — initial situation	+ 100	
Transfer from Treasury	....	(+ 90)
Subtotal — Social Security	+ 100	
Grand total — Unified Budget	+ 0	

Casting the President's program in terms of a modified unified budget does not in any way change the substance of the program. Afficionados of traditional unified budget accounting may wish that the president had presented his program in that form. To have done so would have defeated the objectives of the program. The modified unified budget framework preserves the substance of the program. The key point is that one should not allow the form of the presentation to divert one from the substance of the program, which is where debate should focus. Confronted with truly enormous projected surpluses, unprecedented since the indexation of the personal income tax, should the nation cut taxes or boost spending, two ways of increasing current consumption? Or should the nation save these surpluses to help reduce the deficits of the two largest and most popular programs of the federal government, Social Security and Medicare? This choice is a big issue that should be settled by the electorate in a mature democracy. Legitimate disagreements are possible on the future role of social insurance and on the importance of boosting national saving and economic growth relative to supporting current consumption, private and public. But the nation should confront these issues, not spend its time on a petty and misplaced concern about double-counting.

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Appendix 2

Are the Social Security Trust Funds "Meaningless"?

To see why the assertion that the Trust Fund is meaningless is false, it will be helpful to look at the actual expenditures, revenues, and net asset position of Social Security and the rest of the federal government for fiscal year 1999, as projected by CBO in August 1998. These are shown in the upper half of table 1. The bottom of half of table 1 presents business and pension operations of a hypothetical corporation. The numerical values of this corporation's operations happen to be the same as those for Social Security, but the report is silent on whether the company is reporting in dollars, cents, or some other unit of currency.

Table 2–1: Operations of Social Security and a Hypothetical Corporation

billions of dollars

	Outlays	Revenues	Difference	Cumulative Balance [Surplus (+) or Debt (-)]
Social Security				
Other Operations	1,396	1,359	−37	−4,508
Social Security	325	442	+117	+853
Total	1,721	1,801	+80	−3,655
Private Corporation				
Corporate activities	1,396	1,359	−37	−4,508
Pension	325	442	+117 D	+853
Total	1,721	1,801	+80	−3655

In both cases, it surely seems that a pension fund exists, with a value of 853. Are there circumstances under which one could say that this appearance is misleading?

First, one might say: “well, if the pension fund holds only company bonds, it does not have a secure reserve.” With respect to a private corporation, that statement would be true, as corporations can fail. With respect to the United States government, that statement is false. The United States government cannot fail. The Social Security Fund reserves are rock solid.

Second, one might note that the Social Security trust fund can sell bonds only to the Treasury and that such sales require tax increases, spending cuts, or added borrowing from the public by the Treasury. That situation arises simply because the Social Security Trust Funds are prohibited from selling bonds to the public. It would be equally true if the Trust Fund held corporate bonds or common stocks. It would be equally true of a private company if its pension plan could sell assets only to the parent company. In that event, the corporation would have to raise revenues, cut expenses, or increase borrowing whenever the pension fund liquidated assets. The similar effect of Trust Fund bond sales on the U.S. Treasury has nothing to do with the fact that the Trust Funds hold only government bonds. If the Trust Funds could sell government bonds, corporate bonds, or common stocks on the open market, no such responses by the Treasury would result.

Third, while the Trust Funds have succeeded in adding to Social Security reserves, they may have failed in adding to national saving, if they caused government to run larger deficits or smaller surpluses on the rest of it activities. In short, unwise fiscal policy outside Social Security may have prevented the accumulation of Social Security reserves from increasing national saving.[5] If this unfortunate event occurred, however, the reason is not that Social Security reserves were invested in government bonds, but because of imprudent fiscal policy on activities of government other than Social Security. The reform in budget accounting and in Congressional budget rules that I described above would go some way to reduce this risk.

In summary: Social Security holds real reserves that can be sold to meet benefit obligations. Its income could be higher if it were free to invest as other pension fiduciaries are expected to invest. And it is illogical to deny the reality of those assets because fiscal policy outside Social Security was mismanaged for most of the last twenty years.

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Chairman SHAW. Dr. Steuerle, and I hope I am pronouncing your name correctly.

STATEMENT OF C. EUGENE STEUERLE, SENIOR FELLOW, URBAN INSTITUTE

Mr. STEUERLE. That is correct, Chairman Shaw. In the question-and-answer session for the last set of speakers, several questions came up with respect to details of reform. Let me indicate that I would be most happy to work with this Subcommittee, as I have in the past on details of reform. I was original organizer and coordinator of the Treasury’s tax-reform effort in 1984, which led to the Tax Reform Act of 1986. More recently I worked with the National Commission on Retirement Policy, which was a bipartisan commission, chaired by Representatives Kolbe and Stenholm as well as Senators Breaux and Gregg, to design a reform package. I was instrumental in that package in pushing for a minimum benefit that would help the poor elderly even more than they are helped under the current law, but also in addressing the issue of the extraordinary number of years of retirement support that it provided.

I also supported increasing the retirement age. I have also suggested in the past the idea of a match plan, not too dissimilar from

[5] A similar risk exists with individual accounts or any other form of mandatory private saving. Individuals are free to reduce other forms of saving or to incur additional debt—for example, by running up credit card balances or failing to pay off home mortgages. This problem is greater with individual accounts than with Social Security because the form of individual accounts so closely resembles other private saving.

what the President has proposed, although I am interested in viewing Social Security taxes as one way of paying for that match. So I would be most happy to work with the Subcommittee on different ways of trying to reach some bipartisan consensus.

Now if I were to put that in perspective, I must first address the issues that we were asked to testify on today, and that is why I care so much about the Social Security reform in terms of its impact upon today's children.

As a member of the baby boom generation—the leading edge—I grew up with individuals who, whether conservative or liberal, considered themselves idealists when it came to the role of Federal Government. Today that cohort has come to full power, whether in business or in Congress or as members of the labor force. It is somewhat ironic, I find, that the legacy that baby boomers would now bequeath is one where almost the sole purpose of the Federal Government would be to care for their consumption needs in retirement. I do not believe that this legacy is intended, yet it would come about in the current law, under the President's proposals, and under many of the Republican and Democratic budget alternatives now being considered by Congress. It is largely the consequence of laws written decades ago that are determining almost all the spending priorities of future generations as well as of this Congress.

Let me use a few examples to convey the types of changes that are under way. Using today's prices, an average-income couple retiring on Social Security received about $100,000 in lifetime Social Security benefits about 1960. A typical couple retiring today would receive about $500,000 in Social Security and Medicare benefits, about equal amounts of each, if they were to head to an insurance company and ask to buy that package today. Whereas when the baby boomers retire, that package approaches $750,000. And, yes, under current law the package would exceed $1 million in constant dollars in terms of the benefits promised as we move out into the future.

As another example, out of every dollar in cash wages, the government already requires workers to pay about 15 cents in Social Security taxes plus several cents in other taxes to support elderly and disability programs alone. In the future, that rate of tax could as much as double. Now one reason for these rising costs, and I emphasize rising costs, is that Social Security and Medicare dictate that successive generations should receive higher levels of real benefits than all previous generations.

Another reason is that people are living longer and spending more years in retirement, almost a decade more than when Social Security first began paying benefits. Today individuals claim an entitlement to retire on Social Security for about one-third of their adult lives. Within a few decades, close to one-third of the adult population would be receiving Social Security benefits. Add to that the numbers of people on other assistance programs and you have a substantial, almost a majority of the population, that would be largely dependent upon government and upon the taxes of the children to support them. Of course our children would need to support their own families as well.

Now the basic sources of these budgetary problems that I emphasize is a very high real growth rate built into programs. It is not the level of benefits that are currently being paid. It is the growth rate in these programs. Never before in our history have so many commitments and so much growth been scheduled in our laws literally for an eternity. Our laws now assert to our children that we know better today how to spend all of the revenues they have 10, 50, 100, even 200 years from today. Imagine, by the way, if at the time the Constitution was ratified that our Founding Fathers had put into the law provisions and promises on how to spend the revenues the government would collect today. When the Nation has dramatically increased its financial obligations in the past—through wars, the Louisiana Purchase, assistance to workers and the unemployed in the Depression—if you think about it, the accompanying budgetary commitments were always temporary in nature no matter how large their initial impact. It is the permanence of these new obligations that is so different and so inappropriate.

There are those who would argue that the automatic growth in programs doesn't matter. The plea is made that while we establish them we can get rid of them. What is wrong with making promises that might not be met, promises upon which the Congress would have to renege. Well, one problem is that of flexibility. New needs which must be funded out of new legislation are put at a dramatic disadvantage relative to old needs already prefunded out of old legislation.

In summary, we have only begun our journey toward a domestic policy in which our children are allowed some choice as to what their government will do to meet their needs and those of their children. Getting our budget into surplus after years of large deficits has been a positive development. However, obliging the children of today to pay almost all their future Federal taxes as transfers to support the consumption of their parents is a recipe neither for citizen-led government nor for economic growth.

Thank you.

[The prepared statement follows:]

Statement of C. Eugene Steuerle, Senior Fellow, Urban Institute

Mr. Chairman and Members of the Subcommittee:

As a member of the baby boom generation, I grew up with individuals who, whether conservative or liberal, considered themselves idealists when it came to the role of the federal government. They might have disagreed over optimal size of government or degree of taxation, but they did believe that government should serve its citizens well and should promote civil rights, defend against totalitarianism, and provide opportunity, especially to the poor. Today this cohort has come into full power as members of the labor force, of business, and of Congress itself. It is ironic that the legacy that baby boomers would now bequeath is one where almost the sole purpose of the federal government would be to care for their consumption needs in retirement.

I do not believe this legacy was intended. Yet it would come about under current law, under the President's proposals, and under many of the Republican and Democratic budget alternatives now being considered in Congress. It is largely the consequence of laws written decades ago that are determining almost all the spending priorities of future generations. The greatest difficulty with today's budget policy is not whether either the surplus or revenues are too large or too small, but that the law itself would deny to posterity both the right and the privilege to decide for itself the priorities and needs facing the nation.

Let me use a few examples to convey the changes that are underway:

• Using today's prices, an average-income couple retiring in 1960 received about $100,000 in lifetime Social Security benefits. A typical couple retiring today would receive about $½ million in Social Security and Medicare benefits (about equal amounts of each). Average-income baby boomer couples, on the other hand, would receive around $¾ million, and those who come later are scheduled as much as $1 million (in today's dollars).

- If the number of workers per beneficiary drop from more than 3-to-1 to less than 2-to-1, as scheduled, the children of baby boomers would be required to finance many of these increases in benefits through taxes on their earnings from work. Out of every dollar in cash wages, the government already requires workers to pay 15 cents in Social Security tax, plus several cents in other taxes, to support elderly and disability programs alone. In the future that rate of tax could as much as double. This extraction of more and more out of each wage dollar has been taking place for a long time now; its pace merely increases once the baby boomers begin to retire.
- One reason for these rising costs is that Social Security and Medicare dictate the successive generations should receive higher levels of real benefits than all previous generations. For example, baby boomers are told that, regardless of other needs of the population, they are entitled to receive higher levels of real benefits from their children than they, the baby boomers, transferred to their parents—that this is an entitlement.
- Another reason that Social Security and other retirement programs take ever larger percentages of national income is that people are living longer and spending more years in retirement—almost a decade more than Social Security retirees in the early years of the program. Today individuals claim an entitlement to retire on Social Security for about one-third of their adult lives. More years of retirement also reduce the number of taxpayers for both Social Security and other purposes, thus raising tax rates on those still working.
- Within a few decades, close to one-third of the adult population will be receiving Social Security benefits. Add to those numbers the unemployed or unemployable, or those on other assistance programs, and a substantial portion of the adult population will be largely—in many cases, primarily—dependent upon the children of today to support them through their tax dollars. Of course, our children will need to support their own families, as well, but the share of the budget available to meet the educational, environmental, health research, urban, justice and other needs of our children and grandchildren would be drastically reduced (see figure).

Eternal Commitments of Program Growth for an Unknown Future

The basic sources of these budgetary problems are the very high, real, growth rates built into programs. EVEN if we save all of the currently projected surpluses—something not even the President is proposing—and even if projected deficits were zero forever, we would not have gained control of our budget. That is, even if we could avoid the threat of mounting public debt in the future, there would still be no fiscal slack—resources to be allocated according to current, rather than past, perceptions of needs. Never before in the history of our nation have so many commitments and so much growth been scheduled in our laws literally for an eternity. Our laws now assert to our children—indeed to all future generations—that we know better today how to spend ALL of the revenues they will have 10, 50, 100, or 200 years from today. By way of comparison, imagine if at the time the Constitution was first ratified our ancestors had put into law provisions and promises for how to spend all the revenues that the government collected today.

Never before have dead and retired policy-makers so dominated officials elected today. And never before has so much of policy bypassed the traditional set of breaks applied through normal democratic decision-making. When the nation has dramatically increased its financial obligations in the past—through wars, such enormous land acquisitions as the Louisiana Purchase, assistance to workers and the unemployed in depressions—the accompanying budgetary commitments were temporary no matter how large their initial impact. It is the permanence of our newer obligations that is so different and so inappropriate. It makes no more sense to commit today almost all of the future economic resources that will be available to government than it would be to decide today where to station all of our troops for the next century.

How did we reach this state of affairs? The answer involves several factors. First, societal expectations were built around a higher rate of growth in the 3rd quarter of the 20th century than in the last couple of decades. Second, rapid growth in domestic spending as a percent of gross domestic product was also made possible through peace dividends and reductions in defense spending. Indeed, most of the domestic spending growth over this nation's entire history took place under Presidents Nixon, Eisenhower, Bush, and Truman, who presided over the spending of Vietnam, Korea, Cold War, and World War II peace dividends.

But the drying up of peace dividends and slower rates of growth still do not explain our fiscal straightjacket. Even if the slower economic growth environment of the post-1973 period continues into the future, government revenues per capita, after adjusting for inflation, will still double within another half century, perhaps sooner if we are lucky and engage in good economic policy. Under normal circumstances, this increase of more than one trillion dollars in annual revenues (in today's dollars) would yield significant fiscal slack, projections of surpluses under current law, and new choices for our children and grandchildren.

Given this revenue growth, the only way one can explain the fiscal straightjacket is that past policy makers essentially spent more than all of that growth by building more and more automatic growth into public spending programs. It would be one thing if they merely bought too many goods and services in a current year. Instead, they bought larger and larger levels of goods and services for decades and decades to come.

Two areas have dominated the built-in growth picture in the United States and other industrial nations: health care and retirement security (see table). The demand for health care is virtually unlimited if we have no incentives to care about costs when we go to the doctor or the hospital, or when we buy insurance. Not that the costs aren't borne, they are simply shifted to other insurance buyers and taxpayers. Although most policy makers and individuals define a thousand or two thousand dollars of health expenses as catastrophic, average household expenses on all heath care goods and services is now around $12,000. Again, that's the average. Most government insurance—and, until recently, most private insurance—hid these costs. This insurance has yet to impose adequate incentives, or, alternatively, constraints on prices and utilization to slow down the extraordinary growth in health costs—including growth in payments to doctors and other health care providers.

Social Security and other retirement payments by government, in turn, have grown faster than the economy largely because of improvements in health and longevity. For a typical couple retiring today, Social Security benefits for the longer living of the two will last about 25 years. Those years of support would constantly increase under current law Thus, the cost of the program to workers has risen significantly because there are so many more years of benefits and fewer years of taxpaying.

These longevity cost increases are added to programs already scheduled to grow significantly, because annual benefits to new retirees are indexed to grow as fast as average wages in the economy. This indexing system not only protects retirees against inflation—a worthy goal, in my view—but also promises each successive generation a higher standard of living. If benefits were held to a much more modest rate of growth, it could much more easily finance the retirement of the baby boomers.

In effect, Social Security and Medicare have been designed for almost their entire history and for future decades and centuries to grow faster than the economy. Moreover, more economic growth doesn't solve this problem because if the economy grows faster, then so, too, do these programs. Yet it is impossible for any program to grow faster than the economy forever. Hence the perennial pressure on the budget.

A political consequence of so much built-in growth is that it takes ownership of government away from current voters and their elected representatives. This debate is sometimes framed in the language of mandatory or entitlement spending. In the early 1960s, over ⅔rds of spending was discretionary; today it is less than ⅓rd and the fraction has been declining under both Republican and Democratic budget proposals alike.

Proposals that depend upon the continuation of this type of decline in discretionary spending to continue, as would both the President's budget and many Congressional alternatives, simply has no theoretical or empirical justification. One can assume it only through a mechanical calculation that has no relationship to foreign threats, educational opportunities, transportation demands, the needs of the impaired and disabled, or other future domestic concerns.

AN UNEVEN PLAYING FIELD FOR THE SETTING OF PRIORITIES

There are those who would argue that automatic growth in programs doesn't matter. The plea made is that, well, we established them, we can get rid of them as well. What's wrong with making excessive promises or committing the wealth of future generations as long as we can renege along the way?

Backing up a crystal ball predetermination of future needs with the force of the state is not costless. Extra costs arise inevitably because of the uneven playing field among programs, between entitlement (including entitlement to permanent tax breaks) and discretionary spending, and among entitlements with different built-in growth rates. The impact of the vast differences in the way these types of spending are currently treated can hardly be overestimated. To restrain the automatic growth of entitlement spending requires what is really a super majority—the combination of a simple majority in the House, a simple majority in the Senate, plus the President's support (i.e., no presidential veto), or, alternatively, the combination of two-thirds majorities in both Houses. A super majority is now required to expand discretionary spending—that is, for our children to set their own priorities. Thus, new needs, which must be funded out of new legislation, are put at a dramatic disadvantage relative to old needs, already prefunded out of old legislation. This has been and continues to be a practical recipe for stultifying the responsiveness of government to change.

SUMMARY

In summary, we have only begun our journey toward a domestic policy in which our children are allowed some choice as to what their government will do to meet their needs and those of their children. Getting our budget into surplus after years of large deficits has been a positive development. However, obligating the children of today to pay almost all their future federal taxes as transfers to support the consumption of their parents is a recipe neither for citizen-led government nor for economic growth. The size of the deficit or surplus has never been more than a symptom of the disease from which we suffer, and excessive attention to that number has detracted from dealing with the longer-term direction of policy.

Current law still has built into it extraordinary spending increases of as much 7 percentage points of GDP in a few retirement and health programs within a little over three decades—and then even higher shares of GDP in succeeding years. It is this type of automatic growth that must be brought under control. Our focus must move beyond some narrow deficit or surplus target and toward building a government that is more responsive to the needs and demands of all ages.

Portions of this testimony are taken from The Government We Deserve, by C. Eugene Steuerle, Edward Gramlich, Hugh Heclo, and Demetra Nightingale (Washington, DC: Urban Institute Press, 1998).

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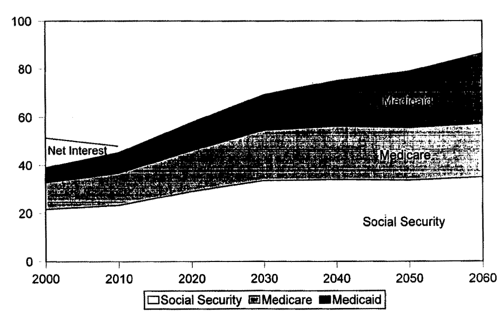
FOUR PRIMARY SOURCES OF GROWTH IN OLD AGE PROGRAMS

- Perpetual growth in annual benefits for each cohort of retirees
- Longer retirement spans
- Lower fertility rates (baby-bust/baby-boom/baby-bust)
- Unlimited subsidies for health care

Federal Expenditures as a Percentage of Revenue

Long-Run Budget Projections of Clinton's 2000 Budget Policy



Source: The Urban Institute, 1999. Based on the Budget of the United States Government, FY 2000.
Note: Net interest not shown after 2010.

Chairman SHAW. Thank you. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Dr. Aaron, you speak favorably of the President's plan. I won't say "glowingly," but favorably of the President's plan, and I think the President certainly put forward some positive proposals that we can look at and perhaps expand upon. But even if we take the President's proposal in toto, and even if all of the economic assumptions underlying his proposal are accurate, he still only extends the life of the program to 2055. That wouldn't take care of my 3-year-old or my 5-year-old. So, I mean it is not that great a proposal, is it, if it only—if everything works just right—and it only takes us to 2055, we are still left with a huge hole, aren't we?

Mr. AARON. You know I work for a think tank, I don't have to run for election. My colleague at Brookings, Bob Reischauer, and I did a book on Social Security reform. We proposed a menu more than sufficient to close the deficit for 75 years and to fund the program, with some benefit cuts, indefinitely.

Now we all know there is a kind of game going on right now with everybody saying, "You first," with the painful suggestions. The Republicans want the President to do it. He would like the Republicans to do it. I wish the President had included a fuller list, but I say that as somebody who is not in the rough-and-tumble political world. He said in his speech that he did not propose enough to do the job, and that is true, he did not. He called upon Members of Congress to join with the administration in fashioning other changes that will go the rest of the way. My own view is it doesn't take a whole lot of heavy lifting to finish the job, if you buy into the proposal that he initially put forward to transfer bonds to the trust fund. A variety of measures will get you to full 75-year balance and beyond. As I say, I wish he had included them. He didn't, but I think the key now is to sit down in good faith—a good faith incidentally that I think Members of the administration and Congress on both sides of the aisle have displayed up until now with respect to this issue. Everybody has been coming forward with proposals, they have been stressing the need for early action, the need for coming together and working jointly on this. And if that spirit can be maintained, I think one could build on the President's proposal to do the whole job, and you should.

Mr. MCCRERY. Well, thank you. I just wanted to let you make it clear that you weren't endorsing the President's proposal as a fix for Social Security; you just think that some of the elements of it are good and we ought to look at those.

Mr. AARON. I think the proposal as presented is a large step in the right direction and, in particular, by defining the choice before the American public as "consume it now or save it for the future," he has framed the issue in the correct way.

Mr. MCCRERY. Well, and obviously we have agreed with that. I mean Chairman Archer and others on this Committee and our leadership have said we are willing to put 62 percent of the expected surplus aside for Social Security.

Mr. AARON. He actually puts about 88 or 89 percent aside.

Mr. MCCRERY. No, not for Social Security he doesn't.

Mr. AARON. No, not for Social Security but for saving.

Mr. MCCRERY. Well, part of that is as his USA accounts, which is like a tax cut. We are not opposed——

Mr. AARON. It is more like a mandatory pension plan, yes?

Mr. MCCRERY. Yes, but it is kind of like a tax cut too. We kind of like that. So we are not averse to looking at something like that as well. As far as Social Security, just Social Security, it is only 62 percent. And we are willing to look at that. But there are ways other than the President has proposed to set that money aside. One does not have to simply buy down the debt currently to set that money aside. There are other ways to do that, and, I don't know if you saw Dr. Feldstein's column today in the Wall Street Journal—I think it was today or yesterday, in the last couple of days—but he brings up an interesting point about double counting some of the estimated surplus the President has proposed to set aside for Social Security. At some point you have to pay off those bonds, and even if it is 30 years down the road, you have to come up with cash at that point to pay off those bonds. So he is you are going to have to find the money somewhere in the budget or raise taxes to do that and to make sure that money actually goes into Social Security.

Mr. AARON. I don't know how Professor Feldstein could have written that column with a straight face. He has been proposing in his plan to use the funds in a way structurally, almost identical to the one for which he roundly criticized the President. I think there are people who have standing to criticize the President's approach, but he is not one of them.

Mr. MCCRERY. Well, except that—if I may take issue with you just a moment—except that under Professor Feldstein's plan, the way he does recoup a large amount of that current expenditure is in the outyears people give back part of their Social Security benefit in return for getting from their individual account. And the President's proposal does not do that. The President's proposal does nothing to stanch the outflow from Social Security. He just leaves a hole there. So I think you might want to read it again and——

Mr. AARON. I have read it carefully, and actually Professor Feldstein makes Gene Steuerle's problem worse. The reason he makes it worse is that his plan increases in pension obligations payable in the future, increasing the transfers that have to be made to the inactive members of the population through pensions. And that would occur at the time when the baby boomers are retiring and at the time we face truly daunting deficits in Medicare. I am worried about the retirement of the baby boomers. I think we may have to trim back benefits somewhat, maybe not as much as Gene would like to do, but we are going to have to trim back benefits some. The last thing in the world you want to do at this point is to increase pension commitments.

Mr. MCCRERY. Well, it is questions like this that we appreciate your input on.

Chairman SHAW. The time of the gentleman has expired. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman. I was going to ask you about Dr. Feldstein's plan, Dr. Aaron. Perhaps you can explain how this plan differs from the President's because that is the way I saw it as well when we had the White House conference and Dr. Feldstein had explained it or tried to explain it. At that time it wasn't quite formed. It was pretty obvious to me that he was using the tax cut for tax benefits that were really part of the Social Security surplus. Perhaps you can go into some, not too much, detail, but some detail on that.

Mr. AARON. Well, my concern about Professor Feldstein's plan comes in two forms. The first is the one I have mentioned. With the retirement of the baby boomers there is going to be an increasing financial burden on active workers to support retirees and the disabled, even under current law. I am very concerned about increasing pension obligations in the face of that baseline situation.

The second source of concern is one to which the President's program has a partial answer. The Feldstein plan would depend for its success on permanent diversions of general revenues into pension obligations into the indefinite future. The President's plan has such a commitment for 15 years. Let me stress, 15 years is long enough. I don't think we can forecast accurately 15 years in advance, and events could well change within that period of time as they have in the past. But at least the commitment is limited.

I am concerned therefore about the threat to future budgets that would arise from the unlimited commitment of general revenues that would occur under the Feldstein plan. In addition, there are administrative issues that have caused Professor Feldstein repeatedly to revise his plan as flaws with version N minus one have been called to his attention. I don't believe, even now, the administrative problems with the version that he has proposed have been fully resolved, but I confess there may be a new version later than the last one I saw.

Mr. MATSUI. Dr. Foster, you—talking about private accounts—what is the total dollar amount of the unfunded liability at this particular time, given current benefits over the next generation, 33 years?

Mr. FOSTER. I don't know what the figure is. Perhaps one of my colleagues would know.

Mr. MATSUI. We have been given a number of about $8 trillion. Is that number, Dr. Aaron, pretty accurate?

Mr. AARON. It turns out the actuaries can calculate these numbers in very different ways. Robert Myers, who is widely respected on both sides of the aisle, has an article in which he presents three estimates of the unfunded liability that differ by a ratio of about 4–1 from the highest to the lowest. Whenever you are running compound interest out into the indefinite future, small differences in method make enormous differences in the results. And those were the findings that he reported.

Mr. MATSUI. So it could be as high as $8 trillion but as low as perhaps, what, $2 to $4——

Mr. AARON. Under some methods of calculating it was on the order of $3 trillion.

Mr. MATSUI. OK. Maybe I can ask you this question then: If you have set up a private-account approach, can you move to a kind of a new system? How do you deal with this $3 to $8 trillion? Perhaps there is a magic way to deal with that?

Mr. AARON. There is no magic way, and it is the reason why, at present, there is complete agreement among academic economists that privatizing Social Security does nothing whatsoever to raise the rate of return available to people. And let me explain why. It is not rocket science.

The great bulk of the payroll taxes we now impose go to support benefits for current retirees and for those who will soon retire. I don't think there is a vote in Congress to pull the rug on those benefits. So we are going to have to pay them. And those benefits represent the unfunded liability, what we are talking about when we are talking about——

Mr. MATSUI. The $3 to $8 trillion?

Mr. AARON. Yes. What we are talking about when we look for higher rates of return is the investment of the payroll taxes that we levy above that base amount, currently about 20 percent of the revenues flowing into Social Security. We could invest those funds through individual accounts, we could divert them now. Of course, then we would have a problem meeting obligations in the future, but for the time-being, we could invest those funds in individual accounts or we could invest them, as the President proposed, through the trust fund, hiring private funds managers.

On the average, in both cases, you are going to earn the average rate of return on the asset category. The only difference is that individual account management will be more costly, and therefore the net return available to support pensions when people retire will be smaller if we do it through individual accounts than if we do it through a centralized system.

With respect to voluntary saving, I am all with those who want to expose people to financial market risk. With respect to the basic retirement program designed to assure basic income, I would like to see us get a fair return from a diversified portfolio in the administratively least costly fashion. And I believe the President's plan meets that test.

Mr. MATSUI. May I just ask one more?

Chairman SHAW. Yes.

Mr. MATSUI. I want to thank the Chairman for giving me this one more opportunity here to ask a question. Dr. Aaron, in answer to the question posed by Mr. McCrery, you said the President starts off and he takes care of the problem until 2055. And then you said we should get the additional 20 years out of it and that is where we can work on a bipartisan basis because my understanding of it, and I want to actually understand this and you can help me with this. That is where the pain will have to come into play. Either you have to raise payroll taxes or you have to make some adjustments on benefits. Is that a correct analysis of the next 20 years to get to 2075?

Mr. AARON. Almost exactly correct. The only qualification, and it relieves you a little bit more, is that there are some corrections in the Consumer Price Index that have not yet been implemented which, when implemented, will have the effect modestly of lowering the projected long-term deficit. So the problem isn't quite so bad. But CPI correction is not going to get you the whole way there, and when it comes right down to it, you are going to be talking about the sorts of proposals that have been discussed by virtually every plan. They appear in the CSIS plan on which Gene worked. They appear on the menu that Bob Reischauer and I put together; they appear in the three plans discussed by the advisory council. And none of them is fun.

Chairman SHAW. Mr. Steuerle, you did some work regarding administrative costs. Do you wish to comment on Dr. Aaron's last answer as to the expense of these programs?

Mr. STEUERLE. I don't think there is any doubt that any unified organization has lower administrative costs than a diversified set of organizations. If we have one auto company, it is cheaper than if we have a lot of auto companies in terms of administrative costs. My fear is not so much on the administrative cost side. I think there are ways to set up individual accounts so the difference in cost is fairly trivial. Dr. Aaron is correct that there is some minor difference.

What I can try to do, however, is offer a slight amendment on the explanation of what the President is proposing in terms of savings. The $2.8 trillion that is going into Social Security is going in under current law. This proposal doesn't change that at all. That is already the initial 62 percent, if you want, of the unified surplus. That is already going in. Now he claims that the Republicans would try to spend that amount as well, and so he is saying that relative to a profligate Congress he may be saving more. But relative to the current law, there is no saving there. He additionally says, let us put a liability in Treasury and an asset in Social Security. So we are going to make this transfer of another 62 percent of the budget. By some accounting, that is approximately 120 percent of the surplus.

But forget about what the surplus is. The proposal is basically saying let us take another $2.8 trillion and let us throw that over into Social Security as an obligation of the Treasury. What that does, at least in that instance, is nothing. At that point, it is just an accounting change, but it obligates future income tax payers to support the Social Security system on top of what the Social Security taxpayers would provide. Now how did the President claim that this would still be a benefit? Well, he is claiming that if you do this, that this will deter Congress from spending that amount of money. And so, therefore, if you look at the graph at the back of my testimony, you will see a little part where the net interest costs to the government go down even while all these Social Security, Medicare and Medicaid costs rise. And so over this period of time, you still have all these rising costs, you still have a budget that is dominated by Social Security, Medicare and Medicaid because the President doesn't propose to cut back on any of these. In fact, he proposes several expansions in terms of drug benefits and help for the elderly poor and some other things. So he doesn't propose to reduce those at all, but he does say that if we reduce these interest costs over time then there is more money left over that we would have otherwise paid in interest cost that we can now devote to these programs.

Chairman SHAW. Mr. Hulshof.

Mr. HULSHOF. Thanks, Mr. Chairman.

Dr. Aaron, I recognize that in the interest of time that you had to confine your remarks, and not able to go into your entire testimony. I have been trying to flip through to make sure I understood. And first of all I really appreciate your use of the term "fiscal incontinence." I would ask your permission to use that in my next speech back home when we talk about Social Security.

I do want to talk a little, though, about this discussion that we have begun—I am sorry—the discussion we have been talking about as far as the unfunded liability. Do you agree with the actuarial number of the year 2013 as generally the year that the Social Security benefits we pay out are going to outpace the Social Security taxes we bring in? Is 2013 the year that you would say is the accurate number?

Mr. AARON. I say nothing independently. I listen to the actuaries, and last year's Trustees' Report had that year.

Mr. HULSHOF. Assuming the year 2013 for the purpose of this question, does the President's proposal change that date?

Mr. AARON. It probably doesn't change it materially. The reason I say probably is that I have yet to see the implications of his proposed change in the retirement test, which might have some effect on cash flow in the short run.

Mr. HULSHOF. As Mr. Matsui pointed out—and I think even he limited it—and most of us consider as we talk about wanting to pay full benefits to Social Security then either we (a) cut benefits or we raise Social Security payroll taxes——

Mr. AARON. Could I qualify my answer to that?

Mr. HULSHOF. Surely.

Mr. AARON. It would have an additional effect. I don't know whether it would move it by a year or two, or what the story would be, but if you can boost the yield on reserves held on behalf of Social Security, that wouldn't affect tax revenues, which is the way you phrased your question.

Mr. HULSHOF. Right.

Mr. AARON. It would affect income flowing into the system. So it wouldn't affect—the answer is it wouldn't affect the answer to the question you posed.

Mr. HULSHOF. We talk about, do we cut benefits as a choice, do we raise the payroll tax? I guess we could continue to borrow. Or third, and let me see if I am reading your testimony, at least between the lines, that we can improve the program by infusing it with more general revenue. Is that right? So we are talking income taxes.

Mr. AARON. I think Gene and I would agree that the effect of the President's proposal is to provide general revenues for Social Security in the long run. My explanation for that is that early in the life of both Social Security and Medicare we paid out benefits vastly larger than taxes people had paid could possibly have justified. That generated the unfunded liability. We are going to have to pay that unfunded liability one way or another. We can ask payroll taxpayers to pay it or we can ask income tax payers to pay it. And the President is saying that he thinks at least in some measure this was a commitment of the Nation the cost of which ought to be borne in proportion to income-tax liabilities.

Mr. HULSHOF. If your position is, or if we have this general discussion about infusing general revenue, that is income taxes, into the Social Security system in the future, why not just lift the wage cap? Why not just lift the Social Security payroll tax cap at 72.6? That way, and even though you are paying more into the system and your benefits that you are going to get are higher, why not approach it from that angle rather than looking at the income tax?

Mr. AARON. I think it is a judgment call. Right now, we already have sizable projected budget surpluses. In that situation, it is harder I think to call for an immediate tax increase, although I expect there are going to be people who will call for it. And it may end up being part of a compromise package at the end of the day. I don't know.

But the big question, I think, is the one I defined, I think. Do we, in effect, reserve the surplus in some fashion to boost national savings or do we spend it? And I interpret the President's whole speech as an effort to advance us down the road toward saving nearly all of the projected surpluses, substantially to boost national saving. It is the funds to Medicare, the funds to Social Security, the USA accounts—all of those will tend to boost national saving. And that is a big question, a big issue. Should we raise taxes some more?

You can make the case, and some people, mostly among the Democrats, argue that we should raise the wage base to restore the proportion of earnings covered by the payroll tax. I think that is a defensible position. But it would probably be embedded in that final tier necessary to get us the remaining 20 years along with, I suspect, some benefit cuts that might have more support from different quarters.

Mr. HULSHOF. Thank you, Mr. Chairman.

Mr. STEUERLE. Mr. Chairman, can I make one addition? I do think the point is important that as this Subcommittee considers proposals. Let me reiterate what I think both Dr. Foster and Dr. Aaron say: none of these proposals is fully developed to date. We know that the real work is for people on this Committee and this Subcommittee in terms of the drafting. There is a distinction in terms of using income tax and general revenues to fund a transition to a more permanently stable program in proposals that make permanent use of the income tax. One of my fears with the President's proposal—because it doesn't use any funds for the transition or it doesn't use any of the benefits of the USA account to change anything else in the system—is that it puts Social Security in permanent dependence upon income-tax revenues if you actually divided this world into Social Security budget and a non-Social Security budget. It is not the only one, by the way. There are a lot of proposals out there that leave Social Security in what I would call a permanent state of deficit that is only financed by constantly having general revenues having to run a surplus.

Now if we do enough saving up front, some people say that is fine. For long run fiscal policy, I think it is a bit dangerous. It would be like saying we could have run the deficits of the eighties because Teddy Roosevelt put aside a lot of National Park land and our wealth is much greater today. Now our saving is much greater, so we can now run deficits. I think there is a danger with this permanent deficit scenario. However, I distinguish between that and proposals that would give you some temporary general revenue infusion to try to help finance this transition, this unfunded liability that we have been talking about.

Mr. AARON. What Gene has just said is the reason why I think it is important to do the final 20 years of the fix. Then you can hold the President, and future Congresses can hold future Presidents to this 15-year commitment, and you are done with it. If you don't fix it up the rest of the way, then I think there is a danger of the outcome that Gene just described. I think it would be undesirable. More importantly, you know the answer the young lady gave up here when asked about what do young people think about Social Security. And she said, it is not Social Security, it is the government they are suspicious of.

I think it is vitally important for members of both parties in the long run that the American public have confidence that you folks know how to do your jobs well. And toward that end, I would hope that when Congress is finished with its work, you can, from both parties, stand up and say to the American public, we fixed Social Security. It is going to take awhile for you to really give credence to what we have done, but over time you are going to understand we fixed it so that it will be there for you. And if you can do that, you will have done, I think, a bigger service than saving Social Security, you will have restored a measure of faith and understanding that this is a democracy in which the elected officials do the people's work.

Chairman SHAW. Dr. Aaron, I can't help but also observe with regard to Ms. Kramer that she did say that she showed a lack of trust in the government but then she supported the program that would have the government doing the investment, which I think is of some concern as to how you ward off certain attacks upon the type of investments. Anything we do would have to have transparency. And who is to say we are not going to get a lot of politics in it? What about investing in an oil company that does off-shore drilling and have the people in Florida all go crazy about it? What about the question of tobacco companies? What about the question of corporations that may not be politically correct as far as their hiring practices? I mean the list goes on and on, and this is the concern of many of us.

The fact that it is insulated today doesn't mean that you are not going to have a bill pass on the floor of the House and Senate and signed by the President tomorrow that would prohibit any of these investments in some of these areas that are not so politically correct. And this is the problem that I see of mischief that we would have the Federal Government blacklisting investments in certain companies. What about the question of accusations, whether they be true or not, as to big contributors getting big investments? I mean the thing is just loaded with fish hooks, and I think those are some of the things that we have to consider in making these things.

I can see, and I am not one to say that the President's plan is dead on arrival—I applaud him for even bringing in the private-sector investments into the formula, whether it be by direct investment of the Federal Government or individual savings accounts or perhaps coming up a hybrid, such as investment in large pools. But the question is, how do you detach investment in the private sector, detach it from political considerations? And that is the big question. If we can get over that hurdle, then I think we can start a meaningful dialog.

With that, I will recognize Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. It is great to have these great minds of Social Security and savings in general before us. I wish we had a few more hours.

I wanted to ask a few questions about savings rates generally. And I know this is not the topic of Social Security, but the President has thrown the USA accounts on the table and, as Dr. Aaron says, I think there is a consensus among economists—right, left, and center—that until we increase our personal savings rate net increase, we are not really going to be able to solve this problem because that will give the economic growth that we will need to sustain ourselves through the baby boom years. My concern about the USA account is very simple and that is it is going to displace existing savings. My focus is on the pension system, particularly the employer-sponsored pension system. Also on the other leg of the stool, the IRAs and so on. I just wondered if all three of you could comment briefly on whether you think the USA accounts would indeed displace what is going on already and what all of us are tying to promote in the 401(k) world and IRA world and so on.

Dr. Foster, you want to go first?

Mr. FOSTER. I don't think there is any question that there will be some displacement, and there is also no question that if you asked a number of economists who study saving behavior, they are going to give you a wide range of estimates of what that displacement would be. That doesn't mean that we shouldn't go about increasing incentives to save, whether it is USA or expansion of IRAs or what have you. There may be some displacement of saving one form for another. That also means there will be some additional saving, and that is an important objective.

Mr. PORTMAN. My concern is that currently you have, in the case of the employer-sponsored plans, of course, an employer match that may in fact be lower. I mean if you are a small employer and you are struggling to provide this SIMPLE, Savings Incentive Match Plan for Employees, plan or 401(k) plan and you have got this other option out there, now you are sort of saying, gee, I will let the government do it. And from what Dr. Steuerle says, we are indeed coming to a point where we are talking about general revenues for us—I am at the other end of that spectrum on the baby boomers. And the last thing we want to do is discourage private investment in savings, whether it is the employer match or whether it is the individual saving on their own.

But I understand what you are saying, you could end up with slight net increases, but you might have less private-sector involvement. There might be ways for the government to make an investment. I like it by expanding contribution limits and simplifying and putting some new vehicles out there like a Roth 401(k) and other things. I think that would be a much more efficient way for the government to invest rather than putting money on a matching basis into account.

But, Dr. Aaron?

Mr. AARON. I think the concern you raise is a real one. There are ways of designing the program to minimize the offsets which will be there inevitably, as Mr. Foster said. First of all, low-income Americans, low earners, just don't save voluntarily very much at all. It is not, as Mr. Foster said, that they just don't have the resources—they managed to save quite nicely from lower-disposable incomes 30 and 40 years ago. The problem is that they are bombarded with an array of temptations to consume today. We all are. And like all mortal people, they succumb to them. Consuming is chic; saving is not.

One of the great potentials, I think, of the USA account is educational exactly along the lines of Mr. Anderson, they can show people that you can accumulate even if it occurs slowly, that compound interest works on your behalf, that savings gets you nearer to achieving some target that you had wanted but didn't think you could reach, and therefore you save a little more on your own. I think there could be some crowding in as well as crowding out through that mechanism, but you have got to be careful in the design to avoid having the plan tell private companies they can get out of the pension business now. I don't think many small employers are going to face the temptation because very few of them, as a practical matter, now provide this coverage.

But I think there is an education function if you can focus USA accounts and include an educational component with them. I would suggest rules that say balances are not just for retirement 40 or 30 years from now, but can be used to help people buy a first home, to send their kids to college, to help them start a business. The wealth-creation ideas that have been popular mostly on the Republican side of the aisle have some real resonance and could be advanced by the USA accounts.

Mr. PORTMAN. Just two quick comments. First, I think if it is not just for an annuity or just for retirement, I think then you get into this issue again that Gene has raised, which is that is our crisis now, that is the problem we are trying to deal with, and although I understand the need to increase savings, and maybe there will be more attractiveness in such an account if people could use it for other purposes, but it doesn't solve the problem. And the question is, how should the government be investing? Is it wise for the government to take on the role as you say of the employer?

Mr. AARON. Let's face it, under the USA accounts, the government is going to be in much the same position that the trust fund would be. The accounts are going to be much too small for a long period of time to allocate them to private funds managers on an individual basis. Administrative costs would kill you. You will have to maintain a central fund, at least until balances reach some threshold level, at which point you could give people the option of moving out into individual management. But if you want to have these funds actually generate some real saving and not get chewed up in administrative costs, the USA account is also going to have to start with some kind of central fund.

Mr. PORTMAN. I know Gene has done some work on this, but there are also some other ways to do that through the private sector, through a regulated system, that is highly regulated but does not have the government investing.

One other quick point: Many of the same positive characteristics you note on a USA account would of course apply to a personal savings account with some percentage of payroll on a voluntary basis, particularly aimed at lower wage workers that Dr. Foster talked about earlier.

Gene, did you have a comment on that?

Mr. STEUERLE. Mr. Portman, I came to this town around 1974, starting at Treasury's Office of Tax Policy, and I don't think a year has gone by where we haven't added some new saving incentive into the tax system. Today the private saving rate is zero. So I think that warns us that we have to be awfully careful. And this has been both on the Democratic side and the Republican side.

Mr. PORTMAN. I will also say that one other statistic just for those listening which is that the amount of benefits paid under the private, employer-sponsored pension system exceeded those benefits paid under Social Security. And we give short shrift to that, I believe.

Mr. STEUERLE. That is correct. That doesn't mean that we don't want to encourage saving and deal with this. What I see in both individual-account proposals and in the President's USA proposal is a chance to try to extend the Social Security debate into the broader debate, which is that we also really need to extend saving, and private pension saving. And the private pension issue has really not been on the table. We have tried it a couple of places—in the NCRP, the National Commission on Retirement Policy and a couple of other places—to put some private pension proposals on the table. But, by and large, the private pension reform—reform of a system that is really only covering now about 30 or 40 percent of the population—hasn't really been on the table. And I see these accounts as a possibility of bringing in that debate.

Let me add, however, having made my earlier comment about our ability to manipulate saving, is there are limits on that ability because in the private economy people can offset whatever we do. They can save less in a different account. A lot of the money that went into private pensions over the past 30 or 40 years has also funded this vast expansion of credit cards. So people can borrow on the other end. In a private economy, you can't totally control saving. And that brings me to one of my greatest fears.

If you look at what is causing the Social Security problem to come to a head, the basic issue is a labor-force problem. It is this decline in workers from about 3–1 to 2–1, as long as we keep retiring for a third of our adult lives. We think that we can rely on a smaller and smaller population to take care of Social Security, but there is a limit on how much we can build steel mills to offset the decline in steelworkers. If there aren't any steelworkers, we can build steel mills until we are blue in the face and we are not going to produce much. And so my fear is trying to rely entirely on saving proposals. It gives this nice idea that, boy, we can really "grow" the economy, as we love to say. We can grow the economy and solve everything and we don't have to make hard choices.

Yet it is fundamentally a labor-force problem, and the saving has to be put into perspective. It is something we want to encourage more of. You need to save a lot more if you are going to have retirement. We need to fix up our private pension system. It would be a lot better in Social Security and other congressional bills in which there are future liabilities that we put money aside today instead of just making promises for the future. That is a pure matter of budget policy, but we still have to be very careful about not setting up the system so that it depends too much on our hopes as to what we can do with saving coming to fruition. We just don't know, so we still build a basic system—a basic benefit system, especially for low-income people who are not going to get a lot of these private savings, no matter what we do. For the bottom 30 percent of the population, we build a basic system that is almost better than current law and then we try to build up much more saving in the middle class. Then finally we recognize that we have to deal with this labor-force issue.

Chairman SHAW. I have just one question. This might go down as the dumbest question asked today, but I am sensing a common thread through this panel, although we seem to be highlighting the differences of opinion. I would like each of you to answer this starting with Dr. Foster. We have got a wealth of education sitting before us at this table. Do you think that you three gentlemen could sit down and draft a plan of investment in the private sector as part of a Social Security bailout plan that would be supported by the President, the moderate to conservative Democrats, and the majority of the Republicans?

He will have to make that point to call himself. Dr. Foster. You think there would be any possibility of that?

Mr. FOSTER. Yes sir, I do. I really don't think——

Chairman SHAW. Watch out, I may ask you to do it.

Mr. FOSTER. I thought about that. That is why I paused. I really don't think we are as far apart as sometimes our rhetoric tends to lead us. We all agree on what the basic problems are. We have got the solutions down to a fairly narrow range where it gets down to really one big issue: Is the money going to be invested in Social Security per se, in government bonds, or are individuals going to control the money? That is the central core issue. That is what we have boiled the whole thing down to. And as all things, we will probably end up compromising on that. So I think we would be able to do so.

Chairman SHAW. Dr. Aaron.

Mr. AARON. I don't think the three of us could agree. But I think perhaps one or more of us could design a plan that would meet your test of winning approval from the President and the majority of Congress. [Laughter.]

Bob Reischauer and I tried very hard to work through an institutional framework that would meet the very legitimate concerns you expressed, Mr. Shaw, with respect to investing a portion of the trust funds in private stocks. I think if we sat down and went through that plan and considered the nature of risks under that plan and under a system of individual accounts, I believe that I could persuade you and, I think, the majority of Members of Congress that it was possible to design a set of institutions for such investment that would be a safe and as immune—not completely immune—but as immune to political interference as would be a system of individual accounts.

Chairman SHAW. Dr. Steuerle.

Mr. AARON. Let me just add one more point that I think is important to keep in mind. The President's proposal, with respect to investing in common stocks, is very, very limited. At its maximum, the proportion of stocks outstanding that would be held in the name of the trust fund administered by private funds managers would be smaller than the current proportion of stocks managed by the Fidelity family of funds. We are not here quaking over the possible seizure control of the American economy by the Fidelity family of funds. Under the President's plan, authority would be diversified among a number of private funds managers, not government managers but private funds managers, much as they are with every family of funds. And the total holdings would be very modest. Therefore, I think the concerns that undue influence could be exercised would be minimal and I believe there are institutional safeguards that would present you and your successors with a set of choices that would make it most unattractive to vote in favor of the bill you described to bar or require investments in a particular company.

Chairman SHAW. Dr. Steuerle.

Mr. STEUERLE. Mr. Shaw, I think the three of us could come close. I would say that one of our principal limitations is that you and your colleagues are going to have to avoid those people who draw lines in the sand. That is our biggest obstacle. When I was at the President's White House conference, I indicated that some people say we can't have reform unless we have individual accounts, and other people who we can't have reform without the accounts. So with or without the accounts, we can't have reform. Then there are people who say we can't have reform if touch benefits at all. And so these lines in the sand are working against reform.

Let me indicate the type of thing we did at the National Commission on Retirement Policy. First let me be quite blunt, I think other commissions that I have seen around this town have been badly set up. When you set up commissions, you stack them, and you stack them with people who are willing to compromise and reach a solution. And if you put on them people who are trying to represent every interest group and not willing to compromise, you don't get anywhere. But I am not saying that the NCRP commission was perfect.

There were people on that commission who felt very strongly about individual accounts. And so we did add an individual account. There are people who don't like it; they fear its long arm of political repercussions. But I proposed to deal with the other issue that I know people worried about the individual accounts, and that is reducing risk, especially for old, poor people. What we put on there was a new minimum benefit that I am told by the Social Security actuaries—this is a rough estimate—increased what is called the primary insurance amount for about 10 percent of males and about 50 percent of females. Now a lot of those females receive spousal benefits. So that is not the number of people who got increases in benefits. And there were retirement-age increases in there too. So I don't want to imply that everything we did protected some people from paying costs. But it shows that if you combine proposals, you can do several things simultaneously, like increase individual accounts, and help the poor. If your fear of individual accounts is adding risk for low-income people, you make other changes elsewhere to set up minimum benefits. And it is that type of compromise that I think that would allow one to reach a final solution. But we can't get there if these lines in the sand prevent us from taking any of these steps.

Chairman SHAW. Well, I haven't detected any lines in the sand with regard to the three of you. If you would care to pursue, I would like to hear from you. I feel a little better about the possibility of coming out of this hearing then I did coming into this hearing because of different camps being set up that seemed to be inflexible. However, I think that we have made some groundwork here today and I appreciate your being here.

Mr. BECERRA. Mr. Chairman.

Chairman SHAW. Yes, sir.

Mr. BECERRA. Could I be allowed to ask a couple of questions, Mr. Chairman?

Chairman SHAW. Just a couple. I am going to go ahead and——

Mr. BECERRA. I will limit it to one question. It will be very straightforward. I thank the Chairman for the indulgence.

I know that most of you have expressed some opinions about what components could make up a good package for reform of Social Security. Mr. Aaron, I have read most of your book and I know that you have identified some of those components. Mr. Steuerle, I believe a lot of what you have done was the principle by which the Stenholm and Kolbe legislation was introduced in the last Congress. Dr. Foster, I am not really certain whether you have helped pull together a package, but would any of you be interested in trying to tell us what would be in your package of Social Security reforms to get us to that 75 years that we need.

And fortunately, as Dr. Aaron said, you are not politicians and you can probably speak publicly. I was wondering what would be in your basket of goodies to try to resolve the problem for Social Security. Please answer as briefly as possible.

Mr. AARON. Well, notwithstanding Mr. Shaw's statement about the risks associated with investment in common stocks, I would begin with supplementing the President's budgetary transfers with proposals to invest a larger proportion of the trust fund in common stocks than the President proposed. I think he is being exceedingly moderate and very cautious—too cautious to my taste. In addition to that, there are a variety of benefit cuts that deserve serious consideration. One would be removing the hiatus, the break, in the increase in the age at which full benefits are paid. That would contribute modestly to closing the deficit. Slightly extending the benefit computation period would contribute somewhat to closing the deficit. It would also work to the disadvantage of women, and to deal with that I think it is important for any proposal to include the provision to which the President alluded in his speech, an increase in benefits payable to surviving spouses. The group among the elderly that is most needy are elderly widows. That reform could go some way toward meeting that problem. It costs money. It would deepen the projected deficit and make the problem a little harder to solve, but I think it should be included.

Reischauer and I also proposed moving the provisions with respect to taxation of Social Security benefits to parallel with those applied to contributory private pensions, which is basically what Social Security is. We saw no reason for having differential tax treatment. We did not include, but I know there has been much discussion of the item that was mentioned before, somewhat increasing the wage base in order to restore it to previous levels the proportion of earnings covered by the payroll tax. If you did those things, together with what the President has proposed, you would overfinance the system. Some benefit cuts, some revenue increases, and the system would be overfinanced for the next 75 years. What I have described, then, is something that you could start with and then carve out those provisions that seemed to you objectionable, that you didn't really feel you wanted to support. You could still end up with a program to correct fully the projected long-term deficit.

The one thing that I would not do, and I think the gentlemen on each side of me would do, and the President has declared firmly he would oppose, is carve out any portion of the payroll tax to support individual accounts. And this gets back to a question Mr. Matsui asked in the first panel. Let me work the arithmetic briefly.

Revenues are 13 percent of payroll more or less, benefits are 15 percent of payroll more or less. Disability and survivors benefits are about a third of benefits, or about 5 percent of payroll. Let's suppose we maintain those. We don't cut disability or survivors benefits. That means we are spending 10 percent on retirees benefits, and there is 8 percent of the payroll tax left over to cover retirement benefits. That would mean a 20-percent initial shortfall in the retirement program. You could also solve that by cutting benefits 20 percent across the board. You could also solve it by increasing taxes 25 percent across the board, 25 percent of 8 gets you to 10. If you take 2 or 3 percent out of the payroll tax, you have converted what is a significant problem financially into a huge one with respect to the basic Social Security program. Chop out 2 or 3 percent from the payroll tax, we are looking at 40- or 50-percent cuts on the average in that basic retirement program. I think it is for that reason the President did draw a line in the sand on carveouts. I think he indicated very clearly he would not support such a plan. I think was correct to do so for the reasons I have indicated.

Chairman SHAW. Mr. McCrery has another question.

Mr. MCCRERY. Just following up on that scenario, though, Dr. Aaron, at least for the short term, and I am speaking in the next 10 to 15 years, we could cover that give-back with the surplus quite easily. So you wouldn't actually have to carve out any of the 12.4 percent, you would in essence be doing what the President proposes and take $700 billion and he wants to put it in the stock market, controlled by the government, we might want to take that the $700 billion and give a 2-percent rebate to individuals to invest in the stock market. So it is doable in the short term, over the short term at least. Long term, admittedly, you have a problem, just as the President has a problem with his proposal.

Mr. AARON. It is different though because the President returns these funds to Social Security and thereby increases the capacity to deliver on assured basic income. If you move the funds into a private account, people will be exposed to financial market risks and the program that provides assured basic income would have to be cut 40 or 50 percent, in the long run.

Mr. MCCRERY. Well, not necessarily. Not if you tie the account back to their Social Security benefits, which we could do. But, let me get to my question because you seem to very familiar with the President's proposal, Dr. Aaron.

I think I read that the President's proposal to invest about $700 billion of the surplus in the stock market only gets us about 5 years of additional solvency in the Social Security Trust Fund. Is that right?

Mr. AARON. My recollection was five or six.

Mr. STEUERLE. Just to clarify, the Deputy Secretary of Treasury recently was in a meeting where he said, "Well, you know, we didn't solve all of the problem. Congress could do several things." And he listed three or four. He said the last one is benefit cuts or tax increases, which he said you probably don't want to do, implying those are hard choices. He said what you might want to do is increase the percentage of the trust funds invested in the stock market and you might want to make an even bigger transfer of obligations of Treasury over to the trust funds.

So be careful with the notion that this is a very limited risk that is going to be put on the population. The administration is already offering to increase that risk. I would just like to say that the risk of stocks are there no matter what. The question is who bears the risk? And one of my concerns, whether it is individual investment or public investment, is that we think closely about who bears that risk, and that we put the risk on people who, if the stock market falls, can bear it. The danger I find in a pure public plan where the government invests is the burden it implies for the nonelderly, who in many cases are poorer than many of the elderly, particularly the young, middle-aged people in their late sixties who I really don't think are elderly anymore. If we put the risk on young people rather than old people, and if the stock market does fall and they must cover those liabilities, I think that could be a big mistake.

Mr. MCCRERY. Well, that is the point I was going to make. Dr. Aaron himself said he would prefer to put a much larger percentage of the surplus into the stock market, and the point is we are only getting 5 years out of the President's proposal. So to really get a lot of work out of that, you would have to put a lot more of the surplus into the stock market, and then you really do get to the question of to those who have concerns about having the government putting money in the stock market you are going to really control more than Fidelity does.

Mr. AARON. No. If you increase it, it would be more than Fidelity. But the point is the President's proposal is less than Fidelity.

Mr. MCCRERY. Yes, but the point is, how long could we keep it at that if indeed it does increase returns to the trust fund? Boy, that is an easy way out. Let's do more, and then as you do more you increase the risk.

Mr. AARON. Well, you know there is an argument in terms of just plain justice for doing it. It is a simple argument. You and I, if we have a pension plan, we insist that our pension-fund manager invest in a diversified portfolio. Part of it will be in common stocks, part bonds, maybe some real estate. The reason is we understand that the combination of risk and return is best when you have a diversified portfolio.

Two-thirds of the Social Security beneficiaries get more than half their income from Social Security. Twenty percent get 100 percent of their income from Social Security. For most Americans, the only way to get access to a diversified portfolio and enjoy those returns combined with assured basic income is through Social Security. So my fundamental reason for favoring this approach is that I want my assistant at Brookings, who makes a small fraction of what I earn, to have access to the same kind of investment diversification that I am able to enjoy through other investments. That can happen, I believe, safely, with appropriate institutional safeguards through Social Security.

Let me say in that connection, you know the whole system of government we live under, starting from the Founding Fathers is built on a suspicion of people in places of authority. Our Constitution is designed with checks and balances to minimize those risks. I think it is vitally important that any system that you might design for such investment be replete with protections and safeguards preferably that have a demonstrated record of success.

And I believe there are two models that provide such assurance. One is the thrift savings plan of the Federal Government and the other is the Federal Reserve System, which manages something at least as sensitive as these investments, namely monetary policy. They have stayed independent of you guys. I don't see a stampede on your part, Chairman Shaw, to go to the thrift savings plan and tell them where to invest. Nor do I see any successful attempt by Members of Congress or the President to influence monetary policy. And the reason is we have set up those institutions in a way to make the political cost to you folks of trying to do that simply insupportable. They have worked for decades. They can work in this situation as well.

Mr. MCCRERY. Thank you, Mr. Chairman. Thank you.

Chairman SHAW. That will be the last word. I thank you again for being here. If you care to spend more time together and try to work up something you could agree on or at least come up with some type of a draft that you could critique, we would appreciate it. Your knowledge is vast in this area, and I am very impressed with your testimony.

Thank you, and we are now adjourned.

[Whereupon, at 5:48 p.m., the hearing was adjourned.]

PROTECTIONS FOR WOMEN

WEDNESDAY, FEBRUARY 3, 1999

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SOCIAL SECURITY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:30 p.m., in room 1100, Longworth House Office Building, Hon. E. Clay Shaw, Jr. (Chairman of the Subcommittee), presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE CONTACT: (202) 225–9263
January 27, 1999
No. SS–2

Shaw Announces Second Hearing in the Series on Impacts of the Current Social Security System

Congressman E. Clay Shaw, Jr., (R–FL), Chairman, Subcommittee on Social Security of the Committee on Ways and Means, today announced that the Subcommittee will hold the second day in a hearing series on impacts of the current Social Security system. On this occasion, the Subcommittee will examine Social Security protections for women. The hearing, which began on Tuesday, February 2, 1999, will be continued on Wednesday, February 3, 1999, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:30 p.m. Subsequent hearing days will be announced separately.

In view of the limited time available to hear witnesses, oral testimony will be from invited witnesses only. Witnesses will include Social Security experts and representatives of organizations interested in women's retirement security. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

Working and earnings patterns of women are often interrupted by childbearing or care of older relatives. These interruptions afford women less opportunity to accumulate pension savings for retirement. As a result, many women retire with little or no pensions savings. By the mid-nineties, only 18 percent of senior women received pension income, with annual benefits of only 40 percent of men's. Moreover, women have longer life expectancies than men, and many are economically vulnerable during retirement.

This economic vulnerability is partially offset by several features of the current Social Security program that are particularly important to women. These features include uninterrupted lifetime benefits, cost-of-living adjustments, progressive benefit formulas, and commitment to support spouses and survivors. Although these features provide women with important insurance during retirement, many women receive low monthly benefits from Social Security because of their relatively shorter working careers and lower lifetime earnings. In 1995, women received an average monthly benefit $190 lower than men's. Because one out of five elderly women rely on Social Security as their only source of income during retirement, women are twice as likely to live in poverty as men (13 percent versus 7 percent, respectively).

In announcing the second hearing day, Chairman Shaw stated: "Women make great sacrifices for American families at home and in the work force every day. Despite these often heroic efforts, many women will be forced to live out their retirement years in poverty. We are committed to protecting the safety net provided by Social Security for women today, and exploring how best to modernize the program to better protect women retiring tomorrow."

FOCUS OF THE HEARING:

The second hearing day will focus on how the current Social Security program affects women's incomes in retirement, including Social Security's success in promoting financial security for women. The Subcommittee also will consider witness recommendations for improving the retirement security of women.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the close of business, Wednesday, February 17, 1999, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Social Security office, room B–316 Rayburn House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

—

Chairman SHAW. OK. We will open this hearing. One in five. That is the chance that an unmarried, elderly woman faces of living in poverty under the current Social Security system. Overall, more than 2.6 million elderly women live in poverty after a lifetime of raising a family and increasing numbers spent in years in the paid work force themselves. In fact, with declining welfare roles in an aging society, within a few years, there may be more elderly women living in poverty than young mothers on welfare. That is an awful thought. It is a horrifying thought.

It is important to recognize that this level of senior poverty exists despite Social Security's many built-in protections for women: guaranteed benefits for life, even for those with little personal savings; progressive benefit formulas that aid women working part time or in low paid positions while raising a family or caring for elderly parents; spousal and survivor benefits that favor one earner couples and widows whose husbands were the primary earner; and inflation adjustments that maintained incomes throughout woman's longer life expectancies.

So with the Social Security's looming solvency crisis, our country really faces two questions with regard to women's retirement security. First, how can we maintain Social Security's current protection for women? And second, how can we modernize the Social Security system and improve its protection for women in the 21st century? This will not be easy, but hard problems have never stopped this country before. After all, if our grandparents could create our Nation's Social Security program in the midst of the Great Depression, surely, in the midst of the strongest economy in a generation, we can take the steps needed to save it and improve it for the coming generation of retirees, and I must underscore here, including women.

I welcome our witnesses today and look forward to their answers, especially to my two questions and probably many more that I'm sure I and my colleagues will be thinking of.

Mr. Matsui.

Mr. MATSUI. Thank you very much, Mr. Chairman. I want to thank you for holding these hearings. I think this hearing in particular is an important one because under our current system, which has really been the safety net for many Americans over the last 60 years, women are the greatest beneficiaries. In fact, women receive about 60 percent of the total Social Security benefits, through survivor benefits, disability benefits, and also through their own benefits as well.

So this hearing will underscore the importance of making sure that we don't make huge mistakes by changing defined benefits that are currently in place at this time. Making sure that whatever we do to change the system, we don't increase the disparity in the marketplace today between men and women in terms of earning capacities. So I think this hearing is extremely important to show what the current level of Social Security does for women, and second, how we can actually improve it to make sure that women are even further protected under the future systems that we might develop.

I want to thank you very much.

Chairman SHAW. I think this will be a hearing that will be very beneficial to us in reforming Social Security.

[The opening statement of Mr. Weller follows:]

Opening Statement of Hon. Jerry Weller, a Representative in Congress from the State of Illinois

Mr. Chairman, as we continue the important process of reforming and saving Social Security for future retirees, I commend the Social Security Subcommittee for placing a special focus on the retirement issues facing women.

As the Social Security reform debate progresses, we must keep certain important statistics in mind. First, in 1997, elderly women were almost twice as likely as elderly men to live in poverty. Additionally, the poverty rate for unmarried elderly women was 19 percent in 199. This is a crucial statistic because 60 percent of elderly women are unmarried. Also significant, nearly 30 percent of elderly black and Hispanic women lived in poverty in 1997, making Social Security especially important to minority, elderly women.

Of course, these statistics are startling. Women, even more than men, have come to rely on the Social Security system for financial security in their golden years. Over their lifetimes, because of family commitments, many women cannot accumulate adequate pension savings. By the mid–1990s, only 18 percent of women over the age of 64 received their own pension benefits and their pension benefits were less than half of those received by men.

To help women save for their later years, I plan to again offer legislation to help improve retirement savings opportunities for women and other individuals who opted out of the workforce to raise families. These Catch-up IRAs will also allow individuals approaching retirement the ability to save more for their golden years, and for all savers the ability to make additional “after tax” contributions to their savings plans.

I hope that we can continue to work together to find Social Security reform solutions which protect the special needs of women in their retirement years. I applaud Chairman Shaw for arranging this subcommittee hearing on such an important topic.

Chairman SHAW. There are two witnesses on the first panel. First, from the U.S. General Accounting Office, Barbara Bovbjerg. I’m sure you’ve spent most of your life spelling your name.

Ms. BOVBJERG. Only since I’ve been married. [Laughter.]

Chairman SHAW. To the amazement of—what nationality is that?

Ms. BOVBJERG. It’s Danish.

Chairman SHAW. Danish?

Ms. BOVBJERG. The Americanization is Bovbjerg. Just like iceberg.

Chairman SHAW. Bovbjerg?

Ms. BOVBJERG. Yes.

Chairman SHAW. Thank you. For those of you in the audience, it is spelled B-O-V-B-J-E-R-G. And for someone like me who very often slaughters people’s names, you can understand that was amazingly close.

Barbara is the associate director of Income Security Issues, in the Health, Education, and Human Services Division, and she is accompanied by Francis Mulvey, who is the Assistant Director of Income Security Issues, in the Health, Education, and Human Services Division. Welcome, and we look forward to your testimony. We have your full testimony, which will be made a part of the record. You may summarize as you see fit.

STATEMENT OF BARBARA D. BOVBJERG, ASSOCIATE DIRECTOR, INCOME SECURITY ISSUES, HEALTH, EDUCATION, AND HUMAN SERVICES DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY FRANCIS MULVEY, ASSISTANT DIRECTOR, INCOME SECURITY ISSUES, HEALTH, EDUCATION, AND HUMAN SERVICES DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Ms. BOVBJERG. Thank you very much, Mr. Chairman. I will try to be brief. Mr. Chairman and Members of the Subcommittee, I am very pleased to be here today with my colleague, Frank Mulvey, to discuss women in Social Security reform. I would like to address three aspects of this issue. First, how women fare under the current system; second, how proposals for change within the current structure of Social Security could affect women; and third, how proposals to restructure Social Security by creating privately owned individual accounts could affect women differently than men. My testimony today is based primarily on a report we issued last year to the Subcommittee.

First, women in the Social Security system as it currently stands. Social Security has provided significant income protection for the Nation's women. Several features of the program are particularly advantageous to women, in part, because they live longer than men. The guarantee of lifetime benefits, generous spousal benefits, annual cost-of-living adjustments, and progressive formulas have protected most women from poverty regardless of how long they live. Yet, despite these advantages, the average monthly benefit for retired workers in December 1997, was about $650 for women, compared to $860 for men. This is because Social Security benefit calculations are based mainly on a worker's lifetime earnings, which on average, are lower for women because they work fewer years and they earn less during those years than men do.

Indeed women's labor force participation rates are lower than men's at every age. Women spend more time out of the labor force than men, and as a result, report fewer years of earnings. This is important because Social Security calculates monthly benefits by taking the average of 35 years of earnings. Most women don't have 35 years of earnings, and this lowers their average benefit. The fact that women earn lower wages than men when they do work, also affects their benefit levels. Partly this difference is a function of women engaging in more part-time work than men, and part-timers are generally paid less than full-time workers. But even without that factor, median full-time wages for women were less than 75 percent of what men earned.

My second point addresses the potential effect of changes that pertain to the Social Security system as it is currently structured. Generally changes that reduce current benefits in some broad cross-cutting manner would treat all beneficiaries equally, but would hurt women disproportionately. And this is because as a group, women are more reliant on Social Security for their retirement than men are. Hence, reductions in Social Security represent a higher percentage loss to their total retirement resources than for men. Measures such as reducing cost-of-living allowances, among others, would fall into this category.

Other changes would also affect women differently. For example, proposals to increase the computation period for benefits from 35 years to 38, or even 40 years, would heighten the differences that already exist between men's and women's benefits. Changes to survivor and spousal benefits, both positive and negative, would also disproportionately affect women who were the primary recipients of such benefits.

Now, I would like to turn to my third point, women and individual accounts. With individual accounts, the amounts individuals receive at retirement would be directly related both to the amounts they contributed and to the returns these investments earned. As a group, women can be affected in several ways. Women, who earn less than men, would contribute less to such accounts, and have lower amounts to invest, and so could expect less in retirement than men.

Our work also suggests that women invest more conservatively than men and would thus receive lower rates of return on their investments. While this means that women would not be as exposed to large losses from higher risk investments, their potential long-run returns would almost certainly be lower than men's. The nature and extent of investor education efforts, in combination with a careful design of investment options, could help maximize the effectiveness and minimize the risk of individual account proposals for women.

How individual accounts are paid out at retirement would also matter greatly to women. Because women as a group live longer than men, lump sum distributions would leave some women without resources late in life, should they or their spouse spend the funds too quickly. Mandatory annuitization would help forestall this problem, but under current law would result in lower benefits or higher costs for women and for couples, again, because of women's longer life expectancies. How the proceeds from such accounts are inherited could disproportionately affect women as well. But carefully structuring the payout features of such accounts could help avoid some of these potential problems.

In conclusion, some elements of reform proposals have a potential to affect elderly women adversely. Understanding how some women may be affected by such changes will be necessary if we are to continue to protect vulnerable members of society.

That concludes my statement, Mr. Chairman. Dr. Mulvey and I are happy to answer any questions you or other Members may have.

[The prepared statement follows:]

Statement of Barbara D. Bovbjerg, Associate Director, Income Security Issues, Health, Education, and Human Services Division, U.S. General Accounting Office

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to speak about women and Social Security. Social Security has had a significant positive impact on the nation's elderly. Since 1959, poverty rates for the elderly have fallen from 35 percent to 10.5 percent, thanks largely to this insurance program. Nevertheless, some elderly women are at greater risk of living in poverty. Women aged 65 and older are especially vulnerable. In 1996, 55 percent of older women would have had incomes below the poverty line without Social Security.

My remarks today focus on (1) how women currently fare under Social Security, (2) how they might be affected by some of the proposed changes in benefits to restore solvency, and (3) how women might fare under a system restructured to include individual accounts. My testimony is based primarily upon a report already issued to the Subcommittee. [1]

In summary, women have benefited significantly from the Social Security program. Many women who work are advantaged by the progressive benefit formula that provides larger relative benefits to those with lower lifetime earnings. Women who did not work or had low lifetime earnings and who were married benefit from the program's spousal and survivor benefit provisions. However, women typically receive lower monthly benefits than men because benefits are based on earnings and the number of years worked. Any across-the-board benefit cuts to restore solvency might fall disproportionately on women as a group because they rely more heavily on Social Security income than men. Other types of reform approaches can have positive or negative effects on women depending on how the reforms are designed.

Restructuring Social Security to include individual accounts also will likely have different effects on men and women. Because women earn less than men, contributions of a fixed percentage of earnings would put less into women's individual retirement accounts. Available evidence indicates that women also tend to invest more conservatively than men, and thus would likely earn smaller returns on their accounts, although they would bear less risk. In addition, how such accounts are structured will be extremely important to women. For example, whether individuals will be required to purchase annuities with the proceeds of their accounts at retirement and how the annuities are priced could affect women quite differently from men. How benefits might be distributed to divorcees and how accounts are transferred to survivors could critically affect the retirement income of some elderly women. Understanding the potential consequences of the various reform proposals can help ensure that Social Security continues to protect vulnerable populations, such as elderly unmarried women.

HOW WOMEN CURRENTLY FARE UNDER SOCIAL SECURITY

Social Security has provided significant income protection for the nation's women. While women, on average, have lower earnings than men, the program has several features that are advantageous to women. First, unlike lifetime annuities purchased from private insurance companies, Social Security does not reduce women's benefits to account for the fact that they as a group live longer than men. Second, Social Security uses a progressive formula to calculate individual benefits, which replaces a relatively larger proportion of lifetime earnings for people with low earnings than for people with high earnings. Because they typically earn less than men, women's monthly benefits replace a larger proportion of their earnings. The program also provides benefits to retirees' dependents—such as spouses, ex-spouses, and survivors—and roughly 99 percent of these benefits go to women.[2]

Nevertheless, women receive lower Social Security benefits than men. In December 1997, the average monthly retired worker benefit for women was $662.40 compared to $860.50 for men. This is because Social Security benefits are based primarily on a worker's lifetime covered earnings, which on average are much lower for women.[3] Although labor market differences between men and women have narrowed over time, the Bureau of Labor Statistics does not project that they will disappear entirely, even in the long term. Thus, women can expect to continue to receive lower average monthly benefits than men, although these differences are partially offset by the presence of spousal benefits.

Lower lifetime earnings can be traced to two principal causes. First, women's labor force participation rates (the percentage of the population aged 16 and older who are working or actively seeking employment) are lower than men's at every age. Women's labor force participation rates have increased substantially over the past 35 years, growing from just 38 percent in 1960 to 60 percent in 1997. At the same time, the rate for men fell from 83 percent to 75 percent. Both trends have leveled off since the early 1990s. The difference in labor force participation has implications for women's Social Security benefits relative to men's, since under the current rules Social Security calculates monthly benefits on the basis of lifetime taxable earnings averaged over a worker's 35 years of highest earnings. Because women generally spend more time out of the labor force than men (primarily for reasons associated

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[1] *Social Security Reform: Implications for Women's Retirement Income* (GAO/HEHS–98–42, Dec. 31, 1997).

[2] In addition, the program also provides benefits for the children of retired and deceased workers and for disabled workers and their dependents.

[3] Covered earnings are earnings subject to the Social Security payroll tax, up to $72,600 for 1999.

with child rearing), they have fewer years of taxable earnings; thus, more years with zero earnings are included in calculating their benefits. Even if women and men had identical annual earnings when they both worked, women's shorter time spent in the labor force results in lower average lifetime earnings, which in turn leads to lower retirement benefits. In 1993, the average 62-year-old man had worked 36 years, whereas the average 62-year-old woman had worked only 25 years.[4] Almost 60 percent of these 62-year-old men had a full 35 years of covered earnings compared with less than 20 percent of women.

A second cause of lower lifetime earnings is women's lower wage rates. In part, this reflects the fact that women are more likely to work part-time, and part-time workers tend to earn lower wages than full-time workers. However, even if only year-round, full-time male and female workers are compared, the median earnings for women are still less than 75 percent of men's. The gap narrows when differences in education, years of work experience, age, and other relevant factors are taken into account.

HOW WOMEN MIGHT BE AFFECTED BY VARIOUS REFORM PROPOSALS WITHIN THE EXISTING PROGRAM STRUCTURE

The changes contained in various Social Security reform proposals would likely have a disproportionate effect on women. Many reform proposals include provisions that would reduce current benefit levels, for example, reductions in the cost of-living adjustment and increases in the normal or early retirement ages. Reducing all benefits proportionately would hit hardest those who have little retirement income other than Social Security. Reducing Social Security benefits by, for example, 10 percent would result in a 10-percent reduction in total retirement income for those who have no other source of income but would cause only a 5-percent reduction for those who rely on Social Security for only half their retirement income. Women, especially elderly women, are more likely to rely heavily, if not entirely, on Social Security. Among Social Security beneficiaries aged 65 or older in 1996, about half the married couples, two-thirds of the unmarried men, and three-fourths of the unmarried women (who accounted for almost half of the three groups) relied on Social Security for at least half their retirement income. One-fourth of the unmarried women relied on Social Security for all their retirement income.

Other changes could exacerbate existing disadvantages for some. For example, some proposals would extend the period for computing benefits from 35 years to 38 or 40 years. Because most women do not have even 35 years with covered earnings, increasing the computation period would increase the number of years with zero earnings used in calculating their benefits and, thus, lower their average benefit. The Social Security Administration (SSA) forecasts that fewer than 30 percent of women retiring in 2020 will have 38 years of covered earnings, compared with almost 60 percent of men. SSA estimates that extending the computation period to 38 years would reduce women's benefits by 3.9 percent, while extending the period to 40 years would reduce their benefits by 6.4 percent. The comparable impact on men from an extension to 38 or 40 years is 3.1 percent and 5.2 percent, respectively.[5]

Some reform proposals include a specific provision designed to improve the status of survivors, who are predominantly widows, but simultaneously reduce spousal benefits that generally accrue to women. Under the current system, a retired worker's spouse who is not entitled to benefits under her own work records will receive a benefit up to 50 percent of her husband's benefit and a widow will receive up to 100 percent of her deceased husband's benefit. One proposal would reduce the spousal benefit from 50 percent to 33 percent of the worker's benefit but would increase the survivor's benefit to either 75 percent of the couple's combined benefit or 100 percent of the worker's benefit, whichever is greater. One-earner couples would receive reduced lifetime benefits because the spousal benefit would be reduced while both the retiree and spouse were alive, but the survivor benefit would remain the same as under current law. Two-earner couples would lose some benefits while both were alive if one spouse was dually entitled,[6] but the survivor would receive higher benefits than under current law.

[4] These data include only earnings from 1951 to the year the worker reaches age 61.

[5] These percentages are based on a sample of new awards in 1993.

[6] A person who is dually entitled receives a retired-worker benefit based on his or her own earnings but is entitled to a higher spousal or survivor benefit based on the earnings of a current or former spouse. The dually entitled beneficiary receives the benefit based on his or her own work record plus the difference between that benefit and the higher spousal or survivor benefit.

HOW WOMEN MIGHT FARE UNDER A SYSTEM RESTRUCTURED TO INCLUDE INDIVIDUAL ACCOUNTS

Many reform proposals would fundamentally restructure Social Security by creating retirement accounts that would be owned and managed by individuals. While such accounts can increase benefits for retirees, women on average might not reap the same advantages such investment could bring to men. As stated earlier, the difference is partly the result of women having shorter work histories and lower earning levels which suggests they generally will contribute less to these accounts. The difference is also partly the result of differences in investment behavior.

Women Invest More Conservatively Than Men

Economists have found evidence suggesting that women generally are more risk averse than men in financial decisionmaking. Studies indicate that, compared with men, women might choose a relatively low risk investment strategy for their retirement income accounts that earns them lower rates of return. Although proponents argue that individual accounts could raise retirement benefits for both sexes, an overly conservative investment strategy could leave women with lower final account balances than men, even if both make the same contributions. Thus, even though women could improve their financial situation under a retirement system that included individual accounts, the gap between the benefits received by men and women could increase.

In our December 1997 report, we attempted to calculate the difference in risk aversion between men and women by looking specifically at the differences in how unmarried men and women who were nearing retirement age invested their assets. We examined unmarried individuals because it was not possible to determine who made investment decisions in married households. We found that women aged 51 to 61 in 1992 had a lower percentage of their total assets in stocks, mutual funds, and investment trusts than men did. The returns on these assets are more volatile but potentially higher yielding than others, such as certificates of deposit, savings accounts, or government bonds.[7] On average, we found that the ratio of riskier assets to total assets held by men was 8 percentage points higher than the same ratio for women. Other researchers, looking at participants in the federal Thrift Savings Plan, have also found that women invest less in stocks than men.[8] Our analysis, using different data and focusing on individuals in their prime working and saving years, increases the robustness of this conclusion. By investing less in these riskier assets, women benefit less from the potentially greater rates of return that, in the long run, stocks could generate. At the same time, however, they are not as exposed to large losses from riskier assets. While it is true that in the past U.S. stocks have almost always posted higher returns than less risky assets, there is no guarantee that they will always do so.

Some pension specialists believe that information is a critical factor in helping individuals make the most of their retirement investments. Providing investors with information that covers general investment principles and financial planning advice might help both women and men to better manage their investments and close the gap in the average investment returns received by men and women. While employers are not legally required to provide this type of information, many have done so in the case of 401(k) accounts. It is not clear who would provide such information to workers under a restructured Social Security system that included mandatory individual accounts. The nature and extent of such information and education efforts, when combined with the design of related investment options, are likely to help maximize the effectiveness of, and minimize the risk associated with, individual accounts under the Social Security system.

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[7] Total assets included non-housing equity from checking and savings accounts, money market funds, certificates of deposit, government bonds, Treasury bills, individual retirement accounts, KEOGHs, stocks, mutual funds, investment trusts, business equity, bonds, bond funds and other assets, and housing equity.

[8] Richard P. Hinz, David D. McCarthy, and John A. Turner, "Are Women Conservative Investors? Gender Differences in Participant Directed Pension Investments," in *Positioning Pensions for the Twenty First Century*, ed. by Michael S. Gordon, Olivia S. Mitchell, and Marc M. Twinney (Philadelphia: University of Pennsylvania Press, 1997); Vickie L. Bajtelsmit, Alexandra Bernasek, and Nancy A. Jianakoplos, "Gender Differences in Pension Investment Allocation Decisions," Working Papers in Economics and Political Economy, Department of Economics, Colorado State University (Oct. 1996); and James M. Poterba and David A. Wise, "Individual Financial Decisions in Retirement Saving Plans and the Provision of Resources for Retirement," National Bureau of Economic Research Working Paper No. 5762 (Sept. 1996).

Annuitization Choices Will Affect Retiree's Benefits

How individual account accumulations are paid out also will make a difference in retirement income to many women. Unless otherwise specified, workers could choose to receive their individual account balances at retirement as a lump-sum payment, as some pension plans now allow, to spend as they see fit. If retirees and their spouses do not accurately predict their remaining life spans and consume their account balances too quickly, they may end up with very small incomes late in life.

To preserve retirement income, retirees could be required to convert the capital accumulations in their individual accounts to a lifetime annuity. However, men and women could retire with similar amounts in their individual accounts and still end up with very different monthly benefits if they were to purchase annuities and if the annuities were based on gender-specific life tables.[9] Insurance companies that sell annuities usually take into account women's longer life expectancy and either provide a lower monthly benefit to women or charge women more for the same level of benefits given to men. In the case of employer-provided group annuities, gender-neutral life tables must be used in the calculation of monthly benefits, which ensures equal benefits for men and women with the same lifetime earnings.[10] Requirements to use gender-neutral life tables involve cross-subsidies between men and women.

Insurance companies also pay lower benefits for a joint and survivor annuity that covers both husband and wife than for a single life annuity that covers only the worker during his or her lifetime—again because the total time in which the benefits are expected to be paid is longer. Women are more likely to receive the survivor portion of this type of annuity, since they are more likely to outlive their husbands. Thus, while the total lifetime annuity benefits for men and women may be similar, the monthly benefit women receive, either as retirees or as survivors, will likely be lower and could result in a lower standard of living in retirement.[11]

Other groups of women will also need to be considered if individual accounts are introduced. Under current Social Security provisions, divorced spouses and survivors are entitled to receive benefits based on their former spouse's complete earnings record if they were married at least 10 years. Most of those receiving benefits under this provision are women. Many individual retirement account proposals do not acknowledge divorcees and survivors as having any specific claim on the individual accounts of their former spouses. Under these proposals, the current automatic provision of these benefits would be eliminated. The money in these accounts could become a part of the settlement at the time of a divorce, but the current benefit guarantee to these benefits might be lost.

Mandating the purchase of a joint and survivor annuity with the individual account balances at retirement will reduce the risk that some wives will have little to live on if they outlive their husbands. Requiring gender-neutral life tables would create cross subsidies between men and women. However, doing so could protect retired women against a low living standard that would result simply because they usually live longer than men. The needs of former spouses will also need to be considered in developing individual accounts.

CONCLUSIONS

While the Social Security system has benefited women significantly through the spousal benefit and the progressivity of the benefit formula, women generally receive lower Social Security benefits than men because they work fewer years and earn lower wages. These work and earnings characteristics will affect the relative changes in average benefits for men and women under some reform proposals. In particular, these characteristics will work against women should reforms based on years with covered earnings be enacted. Because of women's longer life expectancy, the creation of mandatory individual retirement accounts could also decrease women's benefits relative to men's if women continue to invest more conservatively than men. Women might also be disadvantaged if the accumulations in these accounts are paid as a lump sum rather than as a joint and survivor annuity based on gender-neutral life tables.

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9 An annuity can be single life, for the lifetime of the worker only, or joint and survivor, for the lifetime of the annuitant and his or her designated survivor.

10 That is, same-aged men and women would receive identical annuity benefits for the same price.

11 Some demographers believe that life expectancy will continue to increase in the future, affecting annuity values. However, it is unclear whether the gap between the life expectancy of men and women will also narrow in the future.

Whether reforms include relatively modest modifications to the current system or more major restructurings that could include mandatory individual retirement accounts, some elements of the reform proposals could adversely affect many elderly women. Because elderly women are at risk for living in poverty, understanding how various elements of the population will be affected by different changes will be necessary if we are to protect the most vulnerable members of our society.

This concludes my prepared statement. I would be happy to answer any questions you or other Members of the Subcommittee might have.

Chairman SHAW. Dr. Mulvey, you don't have a separate testimony.

Mr. McCrery.

Mr. MCCRERY. Ms. Bovbjerg, I am over here. Hello. [Laughter.] It is an unusual arrangement.

Would you make some suggestions as to some possible changes to the current system that would improve the lot of women. One that comes to mind is just simply saying that a woman's or a widow's benefit would be based on 30 years in the work force instead of 35. Something like that. Some suggestions like that you have come across that we can consider.

Ms. BOVBJERG. Well, there are a number of proposals that would have positive effects on women's benefits. As you note, there are some that would reduce the number of years of earnings on which women's benefits are based. There are some that would have the same result as that proposal, that would credit women with earnings for years that they do not work, that they are taking care of family members. There are others that address survivor benefits, of which 99 percent go to women. There are a number of proposals that would have this effect.

I think that the difficulty is that most of them cost money, and much of the Social Security reform proposals are looking to save money. We try to point out the effects that certain proposals would have, the differential effects certain proposals would have on women. Primarily so that when you are looking at a comprehensive proposal, we are all aware of what the effects might be on different groups—not only women—of different pieces of the proposal. But what's really important is to look at the proposal as a whole.

Mr. MCCRERY. Yes. And I appreciate that part of your testimony. I think you did a good job of raising our antenna to the question of how changes or proposed changes would affect everybody in the system, and particularly, women.

One thing that we don't think about enough probably is the fact that even though women get on average a higher rate of return say on their investment over time, their monthly benefit is actually smaller, and it is the monthly benefit that provides their standard of living. So, we have to look at both. We can't just look at it with a CPA's green eyeshade, and say, well, you know, women because they live longer, they get a lot more back. We have to look or we should look at what they are getting per month and what kind of standard of living that provides them. And I think that is one thing you were trying to point in your testimony.

So we appreciate your letting us know of some of the pitfalls of trying to put solutions on the aggregate Social Security system. I can assure you, we are going to look at how it affects women and various individuals as we go through this. It is going to be difficult because a lot think that we ought to make some changes that will cost money for the system, particularly with respect to widows. So it is going to be an interesting process. We appreciate your taking the time to do some research for us and provide us with some valuable input. Thank you.

Ms. BOVBJERG. Thank you.

Chairman SHAW. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman.

I would like to thank you for your testimony, Ms. Bovbjerg, and obviously, Dr. Mulvey, who contributed to the report as well. We appreciate it, and it goes a long way to help us really get an understanding of what the current law does and certainly some of the changes that will be made.

I want to ask you a question. In 1993, the average 62-year-old woman worked about 25 years in the work force, compared to for a male, 36 years in the work force. And 60 percent of the 62-year-old men had a full 35 years of covered earnings, while only 20 percent of the women counterparts had the full 35 years because they worked part time perhaps. I guess the question, if you move over to individual account balances using these same demographic numbers, and these are the most current that we have, does this mean that women would have considerably lower account balances? What would really happen to these account balances when they are out of the work force, but the administrative costs obviously would continue on? Could you respond to those two questions, perhaps, either you or Dr. Mulvey.

Ms. BOVBJERG. Let me respond to the earnings and contributions one first. Women as a group earn less than men, and so would be less well positioned to contribute as much to each individual account.

Mr. MATSUI. Right. Not only earn less than 75 percent of what men do, with the same skill levels and what not, but also length of work time is shorter too.

Ms. BOVBJERG. Yes.

Mr. MATSUI. Which I also asked in this question.

Ms. BOVBJERG. But earn less over a working lifetime.

Mr. MATSUI. Right, exactly.

Ms. BOVBJERG. For reasons of participation in the work force and earnings levels.

Mr. MATSUI. Right.

Ms. BOVBJERG. And so they would, as a group, have less to put into individual accounts than men, and would then expect to get less out at the end.

Mr. MATSUI. Right.

Ms. BOVBJERG. I do want to caution that these are average figures, and there would be a variation among women. Some women would earn a lot, and put a lot into their individual accounts, while others would be less able to do so. But on the average they are——

Mr. MATSUI. Right. And that is——

Ms. BOVBJERG [continuing]. Would be less well off.

Mr. MATSUI [continuing]. That is the case now, even under the current system.

Ms. BOVBJERG. Yes, but the current system has progressive benefit features.

Mr. MATSUI. Right.

Ms. BOVBJERG. That help pull up lower earners relative to higher earners.

Mr. MATSUI. Anyone else? You want to comment on——

Ms. BOVBJERG. Well, you had a second question.

Mr. MATSUI [continuing]. The administrative costs for those? I guess we don't really know. I mean, since there is no system yet.

Ms. BOVBJERG. We are doing work for this Subcommittee on administrative costs and what sorts of implementation activities the government would have to engage in, what it would cost to set up these accounts, what it would cost to administer them, what it would cost to address the payout features at the end. And this is something that we will be working on with you over the next several months.

Mr. MATSUI. The use of preps, Dr. Mulvey? Did you want to——

Mr. MULVEY. I was going to say there is some concern. Very small accounts would be very difficult to administer. They would have high administrative costs relative to the size of the account. And to the extent women would have the smallest accounts, they may be more burdened by administrative costs. Also women are likely to be out of the labor force during some of their prime earning years, fairly early on in their earning years, and so they wouldn't be getting the accumulation and the compounding of those contributions. So they would be doubly disadvantaged.

Mr. MATSUI. The emphasis on the CPI, Consumer Price Index, and the inflation adjustments made I think is an important issue which you wouldn't get on an annuity. What I would like to know is that because women live longer, and I want to put this in real terms, because you gave a kind of a conceptual reason why it is important, but rents do continue to go up for women, and, obviously, food prices go up. Purchasing power goes down if you have static wages or static forms of income. And the CPI is an extremely important aspect of the current system. So that once a woman retires and receives her benefits, she can maintain a level of subsistence, hopefully, outside of poverty?

Ms. BOVBJERG. Well, it is a significant feature. The current Social Security system, and I believe that others have pointed out, particularly, Gene Steuerle at the Urban Institute, that changes that would reduce the CPI could have the affect of reducing the circumstances of the old, which tend to be women, because over time, they would lose more to inflation. They could, under individual accounts, you could purchase an indexed annuity that would go up with inflation, but it would cost you more at the outset. It would take more of your capital to do that.

Mr. MATSUI. So, from what I understand, and I have just done preliminary research, and maybe you can help me, but I understand it is quite expensive because it is hard to forecast. Am I wrong about that, or do you even have any statistics or formula as to how much more the cost might be to have a kind of annuity that is indexed with inflation?

Ms. BOVBJERG. That is exactly something that we are looking at for this Subcommittee.

Mr. MATSUI. OK.

Ms. BOVBJERG. In fact, it is specifically, what are the issues for the payouts, and what are the ways you might annuitize, and what are some of the things that you would have to be concerned about, and that would be one of them. We are fairly early on in this work.

Mr. MATSUI. Well, I look forward to working with you, and I know the Subcommittee does as well. My time has run out. But I want to thank you for your preliminary work, and obviously, we look forward to working with you as the report is finalized.

Chairman SHAW. Mr. Hulshof.

Mr. HULSHOF. Thanks, Mr. Chairman.

Good afternoon. Ms. Bovbjerg, you mentioned in your testimony about the conservative investment attitudes that generally, and I know we are talking in generalities, that women bring to bear on choosing investments. Is there any evidence that maybe this conservative investment behavior would actually change over time? For instance, becoming more familiar with investing, maybe more comfortable with a little riskier investment? Do you have any thoughts on that, Mr. Mulvey.

Mr. MULVEY. There was a study by one of the consulting firms, a pension consulting firm, recently, which held that men and women, who both participate in 401(k) plans, both exhibited the same kinds of investment behavior. So you didn't find a difference when both parties were cognizant. And the problem, of course, is that many, many more men participated in these accounts than women. So, you would think that with education, with training, with experience over time there would be some evening out. It is not a gender-based thing. It is more of an experienced-based thing. But fewer women have had the exposure to investing at this point, but sometime in the future, they might have the same advantages from individual investments.

Mr. HULSHOF. I could just tell you, anecdotally, that in the Hulshof household, my wife works. I'm very proud of her professional career, and I am the more conservative investor of the two of us. And so it is interesting, and I think part of that is just the comfort level, and my wife is very comfortable with taking risks.

I think later on, we are going to hear a little bit about the concept of earnings sharing. Not anticipating testimony coming up, but has, GAO, the General Accounting Office, done any work regarding the possibility of under our current system, the current Social Security Program, of married couples sharing the earnings that are posted to each other's earnings record?

Ms. BOVBJERG. No, we haven't done any work recently on that specifically. I am aware that others have done some work on this, and I have been aware that the Social Security Administration has raised questions about how they would administer it, I think because they don't keep track of who is married to whom. But now you know the sum total of what I know about it.

Mr. HULSHOF. OK. Thank you.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman. It seems to me that to some extent the disparity that you know between men and women is simply carrying forward the disparity, the pay inequity in the wage structure between men and women in many categories doing essentially the same level of work in our society. But as to those women who have suffered pay inequity and then retire and continue to suffer from retirement inequity, about how many women are there, single women in the United States who rely on Social Security for 90 percent or more of their monthly income?

Ms. BOVBJERG. I have it here somewhere.

Mr. MULVEY. I think it is 25 percent currently.

Mr. DOGGETT. We are talking about numbers. That is why I am asking.

Mr. MULVEY. Well.

Ms. BOVBJERG. No, I don't have the individual single ones. I will have to get back to you.

Mr. DOGGETT. It is millions of women, though?

Mr. MULVEY. Millions of women.

Ms. BOVBJERG. I know we have it here somewhere.

Mr. DOGGETT. Aren't we talking about millions of elderly women?

Ms. BOVBJERG. Yes.

Mr. DOGGETT. Who have nothing other than a Social Security check for 90 percent or more of their monthly income?

Ms. BOVBJERG. Yes.

[The following was subsequently received:]

About 5.7 million elderly women rely on Social Security benefits for at least 90 percent of their retirement income—about 1.6 million women in married couples and about 4.1 million unmarried women. Table 1 provides more detailed information on how heavily elderly men and women rely on Social Security benefits during retirement.

Table 1. Importance of Social Security Benefits Relative to Total Retirement Income for Those Aged 65 or Older, by Marital Status and Gender, 1996.

(Numbers in thousands [1])

	Married Couples	Unmarried Men	Unmarried Women
Total Number	8,835	3,264	10,078
50 percent or more	4,683	2,220	7,659
90 percent or more	1,590	1,044	4,132
100 percent	795	653	2,520
Percent	100	100	100
50 percent or more	53	68	76
90 percent or more	18	32	41
100 percent	9	20	25

[1] Except for totals, the numbers in the upper half of the table are estimated by multiplying column totals by the percents in the lower half of the table.

Source: Income of the Population 55 or Older, 1996, SSA Publication No. 13–11871, April 1998, table VI.B.2, page 104.

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Mr. DOGGETT. We have had a variety of witnesses already before the Subcommittee. One claimed that we should have abandoned Social Security long ago. Another said maybe we could experiment with putting 50 percent or more of Social Security into privatized individual accounts. If we should take some of those Social Security benefits away from those individuals and put them into privatized accounts, that stands to have a rather significant impact on the daily life of those women. Does it not?

Ms. BOVBJERG. Well, I think in order for us to evaluate that, we would have to look at the entire proposal. I think that it is a general point that we have made for women, and I think we would make this about any group that is so reliant on Social Security, that if you remove part of that benefit structure and shift them into something else that does not have some of the features that the current Social Security has, they could be disproportionately effected on average.

Mr. DOGGETT. Do I understand, Mr. Mulvey, from your comments about administrative costs being higher for those with the least to invest, that if we went to an entirely privatized system, that the very women who are at the bottom of the ladder with retirement benefits, who may have well been at the bottom of the ladder their entire lives during their working time, that they will also be at the bottom of the ladder when it comes to the administrative costs of an individual retirement account?

Mr. MULVEY. That is true. Their administrative costs will be higher relative to the value of the account, making it difficult for an annuity provider to find her to be somebody you would want to sell an annuity to.

Mr. DOGGETT. The less you have to contribute to one of these privatized experiments, the more you are going to pay on your account?

Mr. MULVEY. Relatively speaking.

Ms. BOVBJERG. But it also——

Mr. MULVEY. It depends on how it is structured.

Mr. DOGGETT. And then with reference to that portion of the Social Security system that focuses on disability benefits, can you explain under these various privatized experiments how it is that the Social Security system could continue to deliver the disability benefit?

Ms. BOVBJERG. Well, there are really a variety of proposals that have proposed some form of private accounts or individual accounts, and many of them essentially leave the Disability Insurance Program with the Federal Government. It varies a lot on how this is treated. I know that this is something that virtually every comprehensive proposal is trying to address.

Mr. DOGGETT. Have you done studies or seen studies on what the costs of the disability system and of maintaining the current level of the disability system would be apart from the retirement system?

Ms. BOVBJERG. Out into the future? We would just use the actuarial evaluations of the Social Security system, and I don't know myself, what the long-term costs are. I can get back to you on that.

Mr. DOGGETT. The same question with reference to the cost-of-living adjustment. Would it be feasible if we are experimenting with removing half or less of the existing accounts out to these experiments, would it be possible to continue the cost-of-living adjustment?

Ms. BOVBJERG. I think anything is possible. I am thinking about which proposals do what, and I think that there is just a really wide variety. There are some that I think are being considered where you could annuitize to an annuity indexed to inflation, and they are on top or part of a Social Security system. So I think it is really hard to generalize about that.

[The following was subsequently received:]

You requested information about the estimated future revenues and expenditures for Social Security's Disability Insurance (DI) program. The data in table 2 below are from the 1998 Trustees' Report and are the latest available. These estimates assume that the DI program will continue under its current structure. How these estimates might change under Social Security reform depends upon the specific nature of the reform package.

Table 2. Estimated Operations of the DI Trust Fund, Calendar Years 1997–2007

(Amounts in billions)

Calendar Year	Income	Expenditures	Fund at End of Year
1997 (actual)	$ 60.5	$ 47.0	$ 66.4
1998	63.8	50.6	79.6
1999	66.4	53.6	92.4
2000	73.3	56.9	108.8
2001	77.2	60.8	125.2
2002	81.1	65.7	140.6
2003	85.3	71.0	154.8
2004	89.7	77.1	167.4
2005	94.5	83.9	178.0
2006	99.3	91.2	186.0
2007	104.5	99.4	191.2

Source: 1998 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, April 28, 1998, table II.F2, page 82.

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Mr. DOGGETT. Thank you.

Chairman SHAW. Ms. Dunn.

By the way, I would like to announce that I have a general policy that I was going to start enforcing regarding the questioning by Ways and Means Members that are not on this Subcommittee. But in that we now have two ladies sitting with us who are not on this Subcommittee, and that this is very much a woman's issue, that I thought it is quite appropriate. I am delighted that they are both here, and I certainly invite them to participate fully with our Subcommittee.

Jennifer.

Ms. DUNN. Thank you, Mr. Chairman. And I appreciate that you are an enlightened Chairman. [Laughter.]

And we appreciate, I am sure, Mrs. Thurman and I, the opportunity to question ourselves.

I have three questions. I wanted to ask first of all, there have been some proposals out there to increase widows' benefits. We know that at the time that the spouse dies, the widow is allowed to claim 100 percent of her husband's Social Security, where it had been 150 percent for the couple before that time. I am wondering if you know of any suggestions that are out there to change this, for example, to change it to 125 percent to soften the blow of that death?

Ms. BOVBJERG. Well, I am aware of one that we have looked at in the process of producing the testimony today, which would change the rules to give the surviving spouse 75 percent of the total benefits, hers and her husband's, which would really benefit the two-earner couples. You would get 75 percent or 100 percent, whichever is greater, 100 percent of the husband's benefit. I am sorry, I can say that again.

Ms. DUNN. That is what you do get now if you are a widow. You get 100 percent.

Ms. BOVBJERG. You get 100 percent.

Ms. DUNN. And so what would be the change?

Ms. BOVBJERG. What this proposal would do is you could either have that or 75 percent of the total of the benefits that you would earn on your own and from your deceased husband's benefits. So in a two-earner household, if each receives $1,000 of Social Security, they would get 75 percent of $2,000 rather than——

Ms. DUNN. That would be good. And is that in your testimony here?

Ms. BOVBJERG. Yes.

Ms. DUNN. Great, great. I will take a look at that. Thank you.

We know that divorced women who have been married for 10 years to their former husband, are able to claim at the time he starts taking Social Security, 50 percent of his Social Security. That intrigued me when I learned about that a few months ago. I am wondering, since this law was written 60 years ago and a time when most women didn't work, is that becoming too much of a burden for the system? I mean do we have these multiple divorce situations where you have wives, lots of wives claiming 50 percent, or does it go the other way, where marriages last for fewer years than 10? And do we need to look at change in that portion?

Ms. BOVBJERG. I don't know the answer to that question. I haven't heard that it is a problem. It doesn't mean that it isn't, but we will look into that for you.

Ms. DUNN. And it may not be a problem that is intriguing though. I think that is something very little known to most women who go through divorces. I think it is one that we need to talk more about.

OK, let me ask you the third question. Working women are entitled to benefits that are based on their own working careers and their husband's working careers, depending on which is larger. Many working women find that they receive little or no additional benefits from the fact that they have paid in over the long year of their working over what a woman staying at home would receive from her husband's benefit. Is there a solution out there for that problem now that we have, in this new age, we have so many spouses that are working?

Ms. BOVBJERG. Well, there are a number of proposals out there for changing this balance and the benefits among the spouses. One of them we just talked about is the survivor benefit, which would very clearly accrue to the benefit of two-earner households. There is discussion of shared earnings although it is not quite clear to me exactly how that would play out for two-earner households. But there are a number of things that are under discussion.

Ms. DUNN. And are some of those in this report that you presented?

Ms. BOVBJERG. Some, but not many. We can get back to you on it.

Ms. DUNN. So you will do some research?

Ms. BOVBJERG. Yes.

Ms. DUNN. Yes, I would appreciate that if you would.

Let me just make one more comment, Mr. Chairman, if I may, since I have a little time left. It seems to me a lot of times when we talk about the new proposals on Social Security, we talk about an either/or situation. I believe, at least what I envision on the personal retirement accounts, that would be a portion of the payroll tax that is paid in. And so when you talk about women's reticence to take risks, we do support risks, I think this system in many cases could still work better for a woman than if she were to leave all her savings and Social Security. The percentage of return from the stock market is greater over the same period of time. I would like to have your comments on that. Wouldn't the woman at the end of the day be better off if she were able to take 2, 3 percent of her payroll tax and invest that in a responsible management company that would put it into the stock market?

Ms. BOVBJERG. It would depend on who she was. It would depend on how much she worked, how much she earned. It would depend on whether she was going to be reliant on spousal benefits in the future from Social Security. It would depend on how savvy she was in investing the money. I think we are generalizing. We are saying that as a group, women invest more conservatively. Some of that is they maybe don't know and they don't have as much to invest, so they are unwilling to risk what they do have. And as Congressman Hulshof mentioned earlier, that varies among families and that could change with more education.

But I think it really does depend on what circumstances they find themselves in. You know, do they become disabled during that period. And so it is really something that does bear, I think, a great deal of scrutiny in looking at the different proposals.

Chairman SHAW. Thank you.

Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman. And being a woman, we really appreciate the fact that you are giving us this opportunity to look at all of the implications that might come about through any kinds of changes. This is really important. I share a lot of the same feelings that Ms. Dunn does, and the ideas that we need to make sure that there is a safety net there for the women in this country. So getting through these is pretty important.

I want to pick up on something that Ms. Dunn talked about, but from a different angle. That is on the issue of divorce and this 10-year issue. What would happen under individual accounts? Do you believe that that same benefit could be provided or would that just kind of go away and these women would have no coverage at all?

Ms. BOVBJERG. It would depend on how you structured the individual account. One of the things that we talk about in our report and in our statement is that, under the current system, if you are married 10 years, you have access to your former husband's benefit. It is really not clear how that would work in individual accounts, unless there were some divorce court order. And this is one of the implementation issues that we are examining for this Subcommittee.

Ms. THURMAN. So it would have to be through the court system maybe making that determination?

Ms. BOVBJERG. Oh, it doesn't have to be. Only absent other law that would say otherwise for disposition of the account. I think there are ways to consider dealing with it, but that is something that we are still looking at.

Mrs. THURMAN. When you did your report, did you also, you talked about the fact that women were less likely to take risk. Did you at any time look at the issues that we have heard about where women are more likely to be the ones to go into those accounts to be used for family emergencies, to buy that home, to pay for a medical expense? Did you look at any of those concerns where women have been generally the ones that have used their accounts in that way if they do happen to have any at all?

Ms. BOVBJERG. We did some work on borrowing from 401(k)s.

Did we do a gender look?

Mr. MULVEY. I don't think we looked at gender. I am sure that those data are available from that study, but we didn't specifically focus on gender. We were looking at if people borrowed from 40l(k)s, whether or not they were worse off from borrowing even if they paid it back, what would be the cost of borrowing in terms of how much less they would have at retirement. But we didn't break it down by gender.

Ms. THURMAN. OK. I would appreciate any of that information that you could get to us. Thank you.

Mr. MULVEY. We will do that.

Ms. BOVBJERG. We will get back to you.

Chairman SHAW. I was quite shocked by the difference in the earning. I mean Social Security, as I understood you said, that the average woman's was $660 a month, and the average man's was $860 a month. That is an incredible gap, which gives us some idea as to the price tag on trying to bring some equity to this matter. That is compounded by the problem that we are going to be facing to be sure that what we do is constitutional. That is, discrimination, gender discrimination.

So, I think anything we do to try to even it out, we can go toward what Mr. McCrery was talking about, maybe boiling it down to less years rather than leaving it at 35 years. That still would leave us with even a bigger problem because I think, unless somebody can come up with some other way of figuring it out, that would have to apply to males as well as females. So that means that the whole thing would be inflated. Am I correct there?

Have you all given any thoughts or research into what Congress could do that would be aimed at trying to bring equity as far as the women are concerned, and the implications as to sex discrimination from the males?

Ms. BOVBJERG. Well, we didn't look into the constitutional——

Chairman SHAW. The lawyers always win, by the way.

Ms. BOVBJERG. Pardon?

Chairman SHAW. The lawyers always win, no matter which side they are on. Have you all looked into that?

Ms. BOVBJERG. Pardon me?

Chairman SHAW. How you all looked into how this could be fixed without sex discrimination?

Ms. BOVBJERG. We haven't looked into that per se, but I think that I did mention that there are proposals that, I believe, would apply to men and women that would credit the individual with earnings for years that they spent care giving, children or their parents or something. That would have a very similar effect to reducing the years of earnings formula to 30 years or something like that, it would cost money.

Chairman SHAW. We could certainly do that.

Ms. BOVBJERG. Pardon?

Chairman SHAW. Yes, we can do that. And it wouldn't be sex discrimination.

Mr. MULVEY. Yes. The system is gender neutral, but there are certain provisions which typically benefit women as opposed to men, like the spousal benefit, for example. Most spousal benefits go to women, but theoretically, they could be either way.

Chairman SHAW. Do you have any figures to share with us of what would happen, say, if you took 2 years prior to leaving the work force to have a child, 2 years afterward, and work out some type of an average in order to give the stay-at-home mom credit for the time they stayed at home taking care of the children?

Ms. BOVBJERG. We haven't looked at that. We would be reliant greatly on Social Security actuaries in assigning figures to that.

Chairman SHAW. That could be helpful. And that is an area where I think the conservatives and the liberals could come together and support in that, because that would certainly do a lot to bring equity to the system.

One other area that I think this Subcommittee should take a close look at. Jennifer brought it up and then Karen followed up on it at some point, and that is the question of why don't we give the courts discrimination in a divorce suit to make some decisions with regard to the distribution of Social Security? It is a pension system, and pension, private pensions are subject to divorce decrees, so why wouldn't the Social Security? Do you have any comments on that? I haven't really thought it through, but it seems like something this Subcommittee should look at.

Ms. BOVBJERG. Well, I guess that I think that, if you were to restructure Social Security and not address the question of how to deal with benefits owed to divorced spouses, that that would be unfortunate. That it would be better to think about these things in advance and consider whether to leave it to the divorce courts or whether to have some mechanism set up to do something that would be more automatic. I don't have advice for you on that, beyond saying that I think we should consider it, consider the different options.

Chairman SHAW. Well, we are looking for a lot of new ideas. You certainly have done a good job for us. We appreciate your being with us this afternoon. Thank you for your testimony.

Ms. BOVBJERG. Thank you very much.

Mr. MULVEY. Thank you.

Chairman SHAW. The next panel, we have Diahann W. Lassus, who is president of the National Association of Women Business Owners from Silver Spring, Maryland, and president and coowner of Lassus Wherley & Associates. We have Edna Coleman, Social Security beneficiary in McLean, Virginia, on behalf of the Older

Women's League; Amy Holmes, policy analyst, Independent Women's Forum; Joan Entmacher, and correct me if I mispronounced that, vice president and director of Family Economic Security, National Women's Law Center; Sharon F. Canner, vice president, Entitlement Policy, National Association of Manufacturers, on behalf of Alliance for Worker Retirement Security; Marilyn Leist, Middle Atlantic regional director of the National Board of Directors, American Association of University Women.

We welcome all of you to this panel. Thank you for taking time to be with us. We have your full testimony and we would invite you to summarize as you feel comfortable. Thank you.

Ms. Lassus.

STATEMENT OF DIAHANN W. LASSUS, PRESIDENT, NATIONAL ASSOCIATION OF WOMEN BUSINESS OWNERS, SILVER SPRING, MARYLAND; AND PRESIDENT AND COOWNER, LASSUS WHERLEY & ASSOCIATES, P.C., NEW PROVIDENCE, NEW JERSEY

Ms. LASSUS. Good afternoon, Mr. Chairman, and Members of the Subcommittee. Thank you for the opportunity to appear before you today. I am a small business owner with offices in New Jersey and Florida. I am also president of the National Association of Women Business Owners, known as NAWBO. NAWBO represents this country's 8.5 million women businessowners and advocates on their behalf. Women businessowners have played a leading role in shaping America's future. We employ over 23.8 million workers in this country, contribute $3.1 trillion in annual revenue to the economy. Our businesses are growing at twice the rate of small businesses in general. We believe the three-legged stool of Social Security, personal savings, and public and private pension plans is being increasingly threatened, and is in need of new ideas and action to ensure that Americans can face a retirement without fear.

The primary issue we are dealing with today is the fact that women who take time away from employment to raise a family and take care of others, including parents, have shorter working careers and lower lifetime earnings. The lower lifetime earnings lead to lower long-term commitments to Social Security and to pensions. What can we do that will provide equitable benefits to these women in a cost-effective way? There are many ways to expand opportunities for women to take control of their financial and retirement future. The following are five recommendations that NAWBO is making to this Subcommittee.

My mother was a single parent and spent most of her career working in restaurants and retail establishments. She never had access to pensions or retirement savings plans. Her basic retirement was her Social Security widow's benefit from my father, who died at the age of 49. These dollars made a difference in the quality of life, but certainly did not provide for all of her needs. But my mother would have been the first to argue that her Social Security check was not a pension check. We know Social Security was never intended to be the sole source of income in retirement, and we need to keep that point in sight as we continue this discussion.

The small business community is extremely concerned about discussions that involve increasing payroll taxes. We believe that increasing taxes has potentially significant negative impact on small business, and is to be avoided at all costs. Such action would slow down the growth of the sector that has continued to grow employment in recent years, as larger corporations merge, downsize, and lay off workers. One alternative to provide a more equitable retirement benefit is a voluntary supplemental Social Security benefit, where individuals could choose to pay in additional dollars to increase the benefit available to his or her spouse.

Another approach used by many educational systems allows for makeup contributions to pension plans when teachers don't contribute for a period of time. Providing women the opportunity to make up contributions in the Social Security or pension system would provide an option for increasing benefits and moving toward a solution to the current discrepancy in retirement income.

We need to expand opportunities to save through other pension options. Many people believe that women save less than men. In fact, they don't. When given the opportunity, women save as much as men do. But women are much more likely to work part time, work for a small business, or be homemakers, which means they have less access to pension plans.

According to the Employee Benefit Research Institute's 1998 small employer retirement survey, there are approximately 23 million small businesses with fewer than 25 employees. Only 17.2 percent of these businesses have a pension plan. In the 25 to 99 employee category, there are approximately 12 million, and they have 41.7 percent coverage of pension plans. This shows very clearly how significant the issue of pensions in small firms is, and the number of employees who currently have no pension or retirement plan coverage.

There are many issues involved. But I will focus on one. The high cost per employee of implementing a pension plan for a small business. One answer can be found in what we call association pension plans. If we can create a larger universe such as an association and reduce the cost per person, we can increase the utilization of pension plans and thereby help women save more.

Number 4 on our list is increasing or removing the earnings cap, which would encourage women and men to work and allow them to continue to help themselves and increase their standard of living in retirement. And last, in a recent survey, our NAWBO members chose privatization of Social Security as an issue they believe is critical. NAWBO supports a system that would start to transition immediately to provide more viable choices for individuals between the current basic benefit system and the new retirement system. We favor a carve-out of current contributions to begin private investment accounts. We believe that these recommendations provide an opportunity to move Social Security and women forward. If we focus on increasing access to pensions and the opportunity to control one's own investments, we can plan for and enjoy a quality retirement.

Thank you.

[The prepared statement follows:]

Statement of Diahann W. Lassus, President, National Association of Women Business Owners, Silver Spring, Maryland; and President and Coowner, Lassus Wherley & Associates, P.C., New Providence, New Jersey

Good afternoon Mr. Chairman and members of the Committee. Thank you for the opportunity to appear before you today to discuss "Social Security protections for women."

I am a small business owner with offices in New Jersey and Florida and provide services to clients in 15 states. I am also president of the National Association of Women Business Owners (NAWBO).

NAWBO represents this country's 8.5 million women business owners and advocates on their behalf from our city halls to international forums. The National Foundation for Women Business Owners (NFWBO), a sister organization, tells us what our community looks like with its ongoing, ground breaking research. NFWBO's statistics are quoted by the business and mainstream media, as well as governments, and even the president of the United States. The National Women Business Owners Corporation (NWBOC), another sister organization, pioneers technology, access, certification and education initiatives to enhance competition by women suppliers in the government and corporate markets. NWBOC has established the first national certification program and created a national database of women-owned businesses for procurement opportunities with the Federal government and the private sector.

Our organizations have developed the network which will be critical to making fundamental change happen. We are the eyes and ears of our community which has allowed us to flourish as leaders for the community. Our strength is drawn from our relationships with our chapters and consortium partners, and our partnerships with corporate America. The work of our organizations are multi-faceted and covers a broad range of advocacy, research, and procurement. We are leaders in technology . . . And we are accountable. In essence, through our complementary missions, we strive to increase opportunities for women business owners to succeed and to continue to contribute to a healthier economy.

Women business owners have played a leading role in shaping America's future. We represent virtually every industry in our country. We employ over 23.8 million workers, which comprise 36% of all U.S. firms, and provide employment to 26% of U.S. workers.[1] We contribute $3.1 trillion dollars in annual revenues to the U.S. economy.[2] Women-owned businesses have grown in number by 78% since 1987[3] including such non-traditional areas such as construction, wholesale trade, transportation, communication, and manufacturing.[4]

Our businesses are growing at twice the rate of small businesses as a whole[5] and have contributed to reducing unemployment; making welfare to work successful; creating new products, services and ventures; and increasing exports.

The "three-legged stool" of Social Security, personal savings and public and private pension plans is being increasingly threatened and is in need of new ideas and action to assure that Americans can face a retirement without fear. We are faced with a Social Security system that is unsound, a rapidly aging population, and unacceptably low rates of personal savings. We need significant public policy and social responses to these issues now. Almost 30 years ago, visionary people like Nobel laureate James Buchanan understood that radical reform of the U.S. Social Security system would be needed.[6]

The primary issue that we are dealing with today is the fact that women, who take time away from employment to raise a family or to take care of others including parents, have shorter working careers and lower lifetime earnings. Lower lifetime earnings lead to lower long-term contributions to Social Security and pensions and therefore lower benefits in retirement. What can we do that will provide equitable benefits to these women in a cost effective way?

The following findings can be found in the results of the study "Not Your Mother's Retirement: Women and Saving in 1998 published by the American Savings Education Council (ASEC). Older and retired women are much more likely to depend on Social Security income. Younger women and those with higher income and educational levels are more likely to rely on employer's pensions or retirement account contributions plus personal savings. Many women under age 35 do not expect to rely

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[1] Source: National Foundation for Women Business Owners and U.S. Small Business Administration

[2] *Id.*

[3] Source: National Foundation for Women Business Owners

[4] *Id.*

[5] *Id.*

[6] James M. Buchanan, "Social Insurance in a Growing Economy: A Proposal for Radical Reform." National Tax Journal, Vol. 21 (December 1968): 386–95

on Social Security as a source of income in retirement because they do not believe the system will exist when they will need it. Women who are currently working are more likely than those who are retired to rely on personal savings including the sale of a home or business and other sources of income.[7]

Let's explore alternatives for the future to expand opportunities for women to take control of their financial and retirement future. There are many ways to assist women in maintaining their quality of life in retirement. The following are NAWBO's recommendations for dealing with this issue:

- Provide for purchase of supplemental Social Security benefits based on certain circumstances.
- Provide make-up opportunities within Social Security and pensions.
- Expand opportunities to save through other pension options.
- Increase or remove the earnings cap.
- Build a new future by providing the opportunity for investment through privatization.

1. Provide for purchase of supplemental Social Security benefits based on certain circumstances.

My Mother was a single parent who spent most of her career working in restaurants and retail establishments. She never had access to pensions or retirement savings plans. Her basic retirement was her Social Security widow's benefit from my Father who died at 49. These dollars made a difference in the quality of her life but certainly did not provide for anything other than basic food, clothing and utilities. But my Mother would have been the first to argue that her Social Security check was not a pension check. We know Social Security was never intended to be the sole source of income in retirement and we need to keep that point in sight as we continue this discussion.

The small business community is extremely concerned about discussions that involve increasing payroll taxes. We believe that increasing taxes has potentially significant negative impact on small business and is to be avoided at all costs. Such action would slow down the growth of the sector that has continued to grow employment in recent years as corporations in the U.S. merge, downsize and lay off workers.

As a small business owner, my company employs many women and a large percentage of them are part-time workers. This is true of many small businesses. If our costs were to increase significantly in order to provide future Social Security benefits, it would, in fact reduce employment opportunities today.

Increasing payroll taxes also creates major problems for low income individuals who are already struggling to make ends meet. My brother is legally blind and has struggled to make ends meet as he earns less than $30,000 per year. His budget is very detailed and has no room for error. An increase in payroll taxes at any level would have a devastating impact on him.

There are other alternatives to provide a higher or more equitable retirement benefit such as a voluntary supplemental Social Security Benefit. Individuals could choose to pay in additional dollars to increase the benefit available to his/her spouse. This assumes that there would be a "basic" benefit but individuals could be eligible for additional benefits if they chose to "purchase" them. This does not increase the payroll tax burden on the individual or on the employer.

2. Provide make-up opportunities within Social Security and pensions.

The major issue facing women in preparing for retirement is the fact that they leave the workforce to have children, and therefore, do not have the same opportunity to accumulate a higher Social Security or pension benefit. Many education systems allow for "make-up" contributions to pension plans when teachers do not contribute for a period of time. Once they begin contributions, they are able to make contributions that were not made in the past. Some systems also offer opportunities to "purchase" pension benefits.

Providing women the opportunity to make up contributions in the Social Security and/or pension system would provide an option for increasing benefits and moving toward a solution to the current discrepancy in retirement income. This could be structured in many different ways. One way would be to take the last year worked before leaving the workforce and the first year after returning to the workforce and coming up with an average. This average could be used to calculate the contribu-

[7] Not Your Mother's Retirement: Women and Saving in 1998, 1998 Women's Retirement Confidence Survey, American Savings Education Council

tions required to make up for the missed years. The actual contributions could be spread over a period of ten years or could be paid as a lump-sum contribution. There are many ways to structure this system to provide more equalized benefits for women who have been away from the workforce for some period of time. This would be even more effective in a system where the individual is able to make these contributions to their own individual retirement investment account.

3. EXPAND OPPORTUNITIES TO SAVE THROUGH OTHER PENSION OPTIONS.

Many people believe that women save less than men. In fact, women save just as much when they have the opportunity to save. But women are more likely to find themselves forced to finance their own retirement after divorce or the death of a spouse. They also are more likely to spend at least part of their working lives as part-time employees or homemakers. This means that they often have less access to pension plans at work. And women generally live longer than men, increasing their need for retirement savings.

According to the Employee Benefit Research Institute's 1998 Small Employer Retirement Survey there are approximately 23,000,000 small businesses with fewer than 25 employees. Only 17.2% of these businesses have a pension plan. In the 25–99 employee category there are approximately 12,000,000 with 41.7% of these companies offering some type of pension plan. This compares to companies with 100 or more employees and approximately 79.4% of them offering some level of pension coverage. This shows very clearly how significant the issue of pensions in small firms is and the number of employees who currently have no pension or retirement plan coverage.[8]

There has been much discussion about increasing Social Security benefits to women. We would suggest that this is not the answer to improving the quality of life for women in retirement. *The answer lies in providing more and better savings vehicles for women.* Many women who leave the workplace to have children return on a part-time basis and end up working for small businesses. One of the reasons these small businesses do not provide pension coverage is because of the high cost of administering these plans on a per employee basis.

Increasing the opportunities to invest in pensions and other retirement options would significantly improve the long-term financial health of women. There are many ways to make this happen. The first is to decrease the cost per person to establish and maintain a pension plan, the second is to provide incentives for small business to implement a pension plan, and the third is to continue to educate business owners about the alternatives they have available to them.

The U.S. Department of Labor and NAWBO have embarked on an education program to inform our members about the SIMPLE plan and to encourage them to participate in establishing pension plans for their employees. There is legislation pending that would provide some incentives for small business to establish and fund pension plans for their employees. We need to do more to educate our women business owners and we need more incentives for business owners to establish pension plans. However, after we move forward in beginning to answer those two issues, the largest issue still remains. The cost per person for small business pension plans is still too high. If small businesses could be encouraged to provide plans for women to have the opportunity to save, it would significantly improve the plight of women in retirement.

How can we reduce the cost of offering plans within small business? The answer can be found in what we call Association Pension Plans. If a larger universe such as an association can create a specific prototype plan and their members (small business owners) can participate at a significantly lower cost than is currently available, it would help us increase the participation of small business in pension plans. More pensions in small business would increase the opportunity for women to save. In the current environment, Associations offer individual pension plans through primarily insurance and brokerage firms today.

An Association Pension Plan would be structured such that if a small company was a member of this plan, any employee could participate. There may be a need for a small minimum contribution per employee to assure participation. However, if reporting requirements are not focused on "each" individual company "top-heavy" rules and other criteria, the cost of reporting and tracking would be significantly lower.

Individual firms would have to give up some flexibility in designing the plan for their firm, but the reduction of administrative costs per person could be significant

[8] Source: Employee Benefit Research Institute (EBRI) tabulations of the 1993 Current Population Survey employee benefits supplement.

with the efficiencies gained by having a single administrator. There could also be significant savings because of the large dollars of pooled assets. Investment management fees could be significantly reduced because of the sliding scale used to determine fees. There would be more incentive for Associations to promote pension set-up and maintenance to their members.

The critical factor here is that we must find ways to reduce the administrative and management costs in order to increase the percentage of small businesses that offer pension plans. This is a crucial part of solving the problem associated with low or no pension benefits for women.

4. INCREASE OR REMOVE THE EARNINGS CAP.

Increasing or removing the earnings cap would encourage women to work and would allow them to continue to provide for themselves. It would also assure a pool of experienced and qualified employees in a labor market that is very tight. This single step would go a long way toward decreasing the number of women who live below poverty in retirement.

I have many clients who really want to continue to work but are not willing to give up Social Security benefits in order to continue to work. This is a tremendous loss of talent in our current job market and can, in fact, reduce the standard of living for these individuals. There are many individuals who are willing and able to work well beyond age 65. They should not be penalized for continuing to contribute to our economy and for wanting to be self-sufficient.

5. BUILD A NEW FUTURE BY PROVIDING THE OPPORTUNITY FOR INVESTMENT THROUGH PRIVATIZATION.

One of the top issues for 1999 for our members is, in fact, Social Security reform. In a recent survey, our members chose privatization of Social Security as an issue they believe is critical. We believe that in a society where we have more opportunities and choices than anywhere else in the world, we should have the right to determine how our dollars are invested. These dollars should be credited to and available for the individual making the contributions, and not for the benefit of others.

NAWBO members believe that the Social Security system can not survive in its present form and therefore believe dramatic change is inevitable. A privatized Social Security system would be essentially a mandatory savings program. The dollars would still be deducted from employee's pay and matched by the employer. But the dollars would be invested through some type of retirement account similar to 401(k) programs and IRAs, with investment alternatives.

It is imperative to move toward a system that allows for investment in stocks and bonds and provides an opportunity for young people to have a positive return and to have confidence that there will be dollars available for them when they retire. Such a system and it's proceeds would be invested for workers and not used immediately to pay present retirees.

We support a system that would start to transition immediately to provide more viable choices for individuals between the current basic benefit system and the new retirement account system. The new individual retirement accounts would provide an effective vehicle for the make up contributions recommended in Item #2.

There are many economic advantages to converting to a retirement account type of system vs. the current pay-as-you-go system. The first is it offers a much higher potential financial rate of return to young workers, gives individuals control over their own retirement, increases workers' ownership in American businesses, and the increased flow of funds into private capital markets could reduce the cost of capital promoting increased capital formation and business creation.

NAWBO supports the current proposals that recommend either a carve-out of current contributions to begin private investment accounts or allocating all current contributions to start these private accounts. We do not support any proposal that includes an increase in payroll taxes.

NAWBO believes that these proposals provide an opportunity to move Social Security and women forward. We believe that if we can focus on increasing access to pensions and the opportunity to control one's own investments we can plan for and enjoy a quality retirement.

Chairman SHAW. Thank you.
Ms. Coleman.

Could you pass the microphone over there? Thank you.

STATEMENT OF EDNA COLEMAN, SOCIAL SECURITY BENEFICIARY, MCLEAN, VIRGINIA, ON BEHALF OF OWL

Ms. COLEMAN. Chairman Shaw and Members of the Subcommittee on Social Security, I am Edna Coleman. I am here on behalf of OWL, the Older Women's League, the only national membership organization to focus on important issues for women as they get older. I want to thank you for the opportunity to be here today. I came because I think I am typical of the millions of women who benefit everyday from Social Security. It is important that when you decide how to make Social Security stronger for the future, you have an idea of the difference that this great program has made in people's lives.

I am 90 years old, and I am a woman, just like more than 70 percent of the people over 85 who get Social Security. I have lived in a retirement apartment in McLean, Virginia, since my husband died 18 years ago. He worked for the Animal Rescue League caring for animals. During the Second World War, I worked at a temporary government job, and worked taking care of older sick people thereafter.

My husband and I had no children, so I am completely dependent on my monthly Social Security check, which is well under $1,000 a month, for all my day-to-day expenses. I also have a small amount in CDs, but they are rapidly being eaten up in medical costs. My doctor has told me that I have every kind of arthritis there is. I have brittle bones and a heart condition, and I have had fourteen operations in the 18 years that I have lived in my current apartment.

I have wonderful medical coverage with my Medicare, including some drug coverage. But my doctor says generic drugs are wrong for my condition, and I spend more than $1,200 a month out of pocket to get my prescriptions filled. For me, Social Security and Medicare walk hand in hand. If I didn't have a steady Social Security check coming every month, I don't know how I would have survived all these years. That check will continue to come every month as long as I live. It is a real lifeline.

That is the really great thing about Social Security. It is something I can thank my husband for, too. I paid very little money into Social Security when I worked. But even though he never earned a lot of money, it is his benefits that keep me comfortable now. My widow's benefit allows me to live in my own place and in comfort, and I appreciate the raise I get every year to meet the increased cost of living.

I have been reading about the changes people want to make to Social Security. I don't think it's a good idea to ask people like me to put their small Social Security benefits in the stock market. I do have my savings in CDs, they are safe and earning some money for me. That is my savings. For my Social Security, the money I need for rent, food, and other day-to-day necessities, I don't want to risk a penny that I don't have to.

I keep hearing about all the baby boomers who will be retiring in the next 20 years. A lot of them will be women, and many will have lived their lives just like I have. I really believe they would want their money safe and secure, and they, just like me, will need to know exactly how much money they can count on each month. Promises of bigger monthly checks are just that, promises. How can you ask women to take that risk? What happens when someone lives as long as I do, but she has made bad investments? Will women have to make a choice between paying rent or getting good health care?

I really like the President's idea of putting some of the surplus into the Social Security Trust Fund. I think that's one of the things you can do that will help Social Security continue taking care of women without risking their benefits or raising their taxes. My husband worked hard to take care of me, and through the Social Security, he is still doing so. I think about the young women of today having to work hard and take care of their children at the same time, and I worry about them. I hope they will have the same security in old age that I have today.

Thank you.

[The prepared statement follows:]

Statement of Edna Coleman, Social Security Beneficiary, McLean, Virginia, on behalf of OWL

Chairman Shaw and Members of the Subcommittee on Social Security. I am Edna Coleman, and I am here on behalf of OWL, the only national membership organization to focus on important issues for women as they get older. I want to thank you for the opportunity to be here today.

I came because I think I am typical of the millions of women who benefit every day from Social Security, and it is important that when you decide how to make Social Security stronger for the future you have an idea of the difference that this great program has made in people's lives.

I am 90 years old, and I am a woman, just like more than 70 percent of the people over 85 who get Social Security. I have lived in a retirement apartment in McLean, Virginia since my husband died eighteen years ago. He worked for the Animal Rescue League caring for animals. During the Second World War, I worked at a temporary government job, and worked taking care of elderly sick people. My husband and I had no children, and so I am completely dependent on my monthly Social Security check, which is well under $1000 a month, for all my day-to-day expenses. I also have a small amount of savings, but they are rapidly being eaten up in medical costs.

My doctor has told me that I have every kind of arthritis there is. I have brittle bones, and a heart condition, and I have had fourteen operations in the eighteen years I have lived in my current apartment. I have wonderful medical coverage with my Medicare, including some drug coverage. But my doctor says generic drugs are not right for my conditions, and I spend about $1200 a month out-of-pocket to get my prescriptions filled. For me, Social Security and Medicare walk hand in hand.

If I didn't have a steady Social Security check coming every month, I don't know how I would have survived all these years. That check will continue to come every month as long as I live. It's a real lifeline. That's the really great thing about Social Security.

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I've been reading about the changes some people want to make to Social Security. I don't think it's a good idea to ask people like me to put their small Social Security benefits in the stock market. I do have my savings in CDs—they're safe, and they're earning some money for me. But that's my savings. For my Social Security, the money I need for rent, food and other daily necessities, I don't want to risk a penny that I don't have to.

I keep hearing about all the baby boomers who will be retiring in the next twenty years. A lot of them will be women, and many will have lived their lives just like I have. I really believe they will want their money safe and secure, and they, just like me, will need to know exactly how much money they can count on each month.

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I really like the President's idea of putting some of the surplus into the Social Security Trust Fund. I think it's one of the things you can do that will help Social Security continue taking care of women without risking their benefits or raising their taxes. My husband worked hard to take care of me, and through the guarantee of Social Security, he's still doing so. I think about the young women of today—having to work hard and take care of their children at the same time, and I worry about them. I hope they will have the same security in old age that I have today.

Thank you.

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Chairman SHAW. Thank you, Ms. Coleman. I wanted just to mention one thing. I don't know of anyone, I know the President hasn't, and I don't know of anybody in Congress that has suggested people receiving the Social Security put money in the stock market. I wouldn't think that would be too wise in your case.

Ms. Holmes.

STATEMENT OF AMY M. HOLMES, POLICY ANALYST, INDEPENDENT WOMEN'S FORUM

Ms. HOLMES. Yes. Mr. Chairman, distinguished Members of the Subcommittee, ladies and gentlemen, good afternoon. My name is Amy Holmes, and I am a policy analyst with the IWF, Independent Women's Forum. It is an honor and a privilege to be invited to speak to you today on behalf of myself and the women of IWF.

The Independent Women's Forum is a nonprofit, nonpartisan organization dedicated to research and public education on policy issues concerning women. The Independent Women's Forum neither solicits nor accepts government funds pursuant to House Rule 11, Clause 2G4. I confirm that IWF has at no time received any Federal grant, contract, or subcontract.

The first person ever to receive a Social Security check was a woman named Ida Fuller. She ultimately received $20,000 in benefits over her retirement from the Federal Government. Not a bad return on $20 paid in taxes, but what a difference 60 years makes. Today, you are hearing from a variety of perspectives on how to reform the system. I will humbly leave the more technical aspects to my colleagues. I come to you as a 25-year-old woman, keenly aware of the impending Social Security crisis and the need to start saving for my retirement sooner, rather than later, more rather than less.

As an African-American, unmarried woman, I can be counted in the categories of recipients most dependent on Social Security for future retirement income. Which means I have a lot to worry about, since when I hit retirement age, there will be fewer than two workers to support my benefits as compared to 8.6 workers in 1955.

In the meantime, according to conservative estimates from Economic 2000, baby boomer Social Security entitlements threaten to push my lifetime tax rates up to an unconscionable 60 to 70 percent. You all know the statistics, and they paint a grim picture. Clearly, the time for reform is now, and three-quarters of American adults agree, according to a recent poll conducted for the Associated Press.

Yet groups that claim to speak for women oppose the reform that would truly liberate women from government dependence and offer us real choice and ownership of our financial future. Instead, groups such as the National Organization for Women, downplay Social Security concern as nothing more than "a Chicken Little atmosphere." According to a recent statement on the NOW Web site, "The threat our families face is not the imminent collapse of Social Security funding, but a possible shortfall after 2032." Well, even if they are right, and this Subcommittee knows well, that the trust fund is filled with paper promises, I simply cannot run the risk of waiting until I am 57 years old to shore up my retirement option. The Feminist Majority warns, that "having a private account means that we bear all the risk of investing." The fact of the matter is, we bear all the risk of Social Security meltdown with no way to hedge against it. According to the 1998 Social Security Trustees' Report, if we stay with the status quo, we will either have to cut benefits by 25 percent, raise taxes by 50 percent, cut government spending on other programs or increase the Federal debt.

I guess I am most baffled by the support of these groups for government investment in the stock market. Such ill-advised investment would give an enormous advantage to large traded companies with all of their alleged problems of wage inequities and glass ceilings over small businesses. And as we have heard, that is precisely where women have made their greatest gain and achieved economic success and independence.

According to the National Foundation of Women Business Owners, women own 7.7 million businesses, employing 15.5 million people in generating a whopping $1.4 trillion in sales. You have heard some even better statistics today. Female-owned businesses are growing more rapidly than the overall economy, and are more likely to remain in business over the past 3 years than the average U.S. firm. I would like to believe that is because women are more likely to stop and ask for directions. It simply doesn't make sense from a woman's point of view to tip the scales against female entrepreneurs in favor of Fortune 500 companies. There is much more to be said on this topic.

But let me close with this. One hundred and fifty years ago, Elizabeth Cady Stanton argued before the New York legislature that we are "persons, native, free-born citizens, property holders, taxpayers," and that a woman has "a right to the property she inherits and the money she earns." How far we have strayed from the cause and true liberations, that in 1999, the possibility of private ownership and control of our retirement assets is controversial, that women are painted as timid and easily duped, and that the freedom to choose and plan for our retirement is better left to the wisdom of government officials.

Reforming Social Security to take into account the differences in women's work history, longevity, and poverty rates, will take imagination and resolve. Earning sharing where spouses split savings in separate accounts, is one such solution. Ensuring a safety net for elderly women, like Edna, who are most likely to suffer from poverty, must also top any reform agenda. But do not be fooled by those who have used our differences to thwart honest efforts. Social Security reform is a woman's issue now more than ever.

Thank you.

[The prepared statement follows:]

Statement of Amy M. Holmes, Policy Analyst, Independent Women's Forum

Mr. Chairman, distinguished members of the Subcommittee, ladies and gentlemen. Good afternoon. My name is Amy Holmes and I am a policy analyst for the Independent Women's Forum. It is an honor and a privilege to be invited to speak to you today on behalf of myself and the women of IWF.

The Independent Women's Forum is a non-profit, non-partisan organization dedicated to research and public education on policy issues concerning women. The Independent Women's Forum neither solicits, nor accepts government funds. Pursuant to House Rule XI, clause 2(g)(4), I confirm that IWF has at no time received any federal grant, contract or subcontract.

The first person ever to receive a Social Security check was a woman named Ida Fuller. She ultimately received $20,000 in benefits over her retirement from the federal government. Not a bad return on the $22 she paid in taxes. What a difference sixty years makes.

Today, you are hearing from a variety of perspectives on how to reform the system. I will humbly leave the more technical analysis to my colleagues. I come to you as a 25 year old woman keenly aware of the impending Social Security crisis and the need to start saving for my retirement, sooner rather than later, more rather than less.

As an African American, unmarried woman I can be counted in those categories of recipients most dependent on Social Security for future retirement income. Which means I have a lot to worry about, since when I hit retirement age, there will be fewer than two workers to support my Social Security benefits as compared to 8.6 workers for every beneficiary in 1955. In the meantime, according to conservative estimates from Economic Security 2000, baby boomers' Social Security entitlements threaten to push my lifetime tax rate up to an unconscionable sixty to seventy percent. You know the statistics—they paint a grim picture. Clearly, the time for bold reform is now. A December poll conducted for the Associated Press found that three fourths of American adults agree.

Yet, groups that claim to speak for women oppose these reforms that would truly liberate women from government dependence, and offer us real choice and ownership of our financial futures. Instead, groups such as the National Organization for Women downplay Social Security concern as nothing more than a "Chicken Little atmosphere." According to a recent statement by Patricia Ireland, "The threat our families face is not the imminent collapse in Social Security funding, but a possible shortfall after 2032." Even if she's right, and the Committee knows well that the Trust Fund is filled with paper promises, I cannot run the risk of waiting until I'm 57 years old to shore up my retirement options.

The Feminist Majority warns that "having a private account means that [we] bear all the risk of investing." The fact of the matter is, we bear all of the risk of Social Security meltdown with no way to hedge against it. According to the 1998 Social Security Trustee Report, if we stay with the status quo, we will either have to cut benefits by 25%, raise taxes by 50%, drastically cut government spending on other programs, or increase the federal debt.

But I am most baffled by the support of these groups for government investment in the stock market. Such ill advised investment would give an enormous advantage to large traded companies, with all of their alleged problems of wage inequities and glass ceilings, over small businesses. And that's precisely where women have made their greatest gains and achieved economic success and independence.

According to the National Foundation of Women Business Owners, women own 7.7 million businesses, employing 15.5 million people and generating $1.4 trillion in sales. Female owned businesses are growing more rapidly than is the overall economy and are more likely to have remained in business over the past three years than the average U.S. firm. (I like to believe it's because women are more likely to stop and ask for directions.) It simply doesn't make sense from a woman's point of view to tip the scales against female entrepreneurs in favor of Fortune 500 companies.

There is much more to be said on this topic, but let me close with this:

One hundred and fifty years ago, Elizabeth Cady Stanton argued before the New York legislature that we are "persons; native, free-born citizens; property-holders, tax-payers" and that a woman has "a right to the property she inherits and the money she earns." How far we have strayed from the cause for true liberation that in 1999 the possibility of private ownership and control of our retirement assets is controversial; that women are painted as timid and easily duped; and that the freedom to choose and plan for one's retirement is better left to the wisdom of government officials.

Reforming Social Security to take into account the differences in women's work history, longevity and poverty rates will take imagination and resolve. Earnings sharing, where spouses split retirement savings in separate accounts, is one such solution. Ensuring a safety net for elderly women, who are most likely to suffer from poverty, must also top any reform agenda. But do not be fooled by those who would use these differences to thwart honest efforts. Social Security reform is a woman's issue—now more than ever.

Chairman SHAW. Thank you, Ms. Holmes.

Ms. Entmacher.

STATEMENT OF JOAN ENTMACHER, VICE PRESIDENT AND DIRECTOR, FAMILY ECONOMIC SECURITY, NATIONAL WOMEN'S LAW CENTER

Ms. ENTMACHER. Yes, thank you.

Chairman SHAW. Am I pronouncing your name correctly?

Ms. ENTMACHER. Yes.

Chairman SHAW. Oh, good. Thank you.

Ms. ENTMACHER. Chairman Shaw, and Members of the Subcommittee, I am Joan Entmacher, vice president and director of Family Economic Security of the National Women's Law Center. I thank you for calling this hearing and for highlighting the importance of Social Security to women at the very beginning of the debate in this Congress. I appreciate the opportunity to testify before you today on behalf of the National Women's Law Center.

I am not going to repeat all the facts and figures that explain why Social Security's guaranteed, lifetime, inflation-protected, progressive retirement benefits are especially important to women. But I do want to stress one point that is especially relevant as Congress considers the future of Social Security and proposals for alternative retirement programs. And that is that, especially for women, Social Security is much more than a worker retirement program. For men, that is what Social Security overwhelmingly is.

In 1997, 82 percent of the adult male recipients of Social Security benefits were retired workers. Only 18 percent of adult male beneficiaries were disabled workers, spouses, surviving spouses, or disabled adult children. In contrast, nearly half of adult female beneficiaries, 44 percent, relied on Social Security's disability and family protections. And these figures do not reflect the additional 4 million children who receive benefits because a parent died or became disabled.

The next point I want to make is that Social Security's protections will continue to be important to future generations of women. It is true that women are working more and earning more than in the past. But don't be misled by the media focus on the situation of one subgroup of women, those with college education and beyond, who really have made striking gains in the last 25 years. That group has made great gains, but that experience is not representative of all women.

In announcing this hearing, you, Mr. Chairman, stated that women make great sacrifices for American families at home and in the work force every day, and that statement is as true for younger women who struggle to balance work and family responsibilities, many holding the same kinds of jobs that their mothers did, as it is for older women who are more likely to be full-time homemakers and care givers. And it means that younger women too will be at much greater risk by changes to the system that would undermine Social Security's protections.

The risks to women from proposals that depend on diverting payroll taxes to individual accounts, and therefore, requiring a reduction in guaranteed benefits, are discussed in my statement and a recent report by the Congressional Research Service. I will also point out that today's USA Today reports that a forthcoming GAO study is purported to find that the Texas privatization plan poses the risks that one would expect: That lower earners do less well than they would under Social Security, that the families of workers who die before retirement do less well than under Social Security, that for middle-income workers, people who live longer and don't have inflation protections do less well than under Social Security. And the only people who do better consistently are people who earn over $51,000 a year, and those are disproportionately men.

So, I don't want to talk more about carve-out plans. What I do want to talk about briefly is another proposal that is getting discussion now, developed by economist Martin Feldstein, that promises to retain the current benefits structure and provide additional retirement income without raising taxes. Sounds too good to be true. Well, unfortunately, it is too good to be true, especially for women. There are three major problems.

The first is that the cost of the plan falls disproportionately on women. This plan is financed by taking all or virtually all of the budget surplus into the foreseeable future. That poses particular risks for women whose health care cost in old age represent the greater burden. And Edna has talked eloquently about that issue today. If all of the surplus goes into individual accounts, there is not going to be anything left for Medicare or Medicaid, which provides long-term care for women, not to mention education, child care, and other programs that women care about.

And in the long run, even if we devoted all the projected budget surplus to funding the accounts, the actuaries at the CBO, Congressional Budget Office, and the Social Security Administration say it won't be enough. Ultimately, benefits will have to be cut and taxes are going to have to be raised. That is not the way to improve benefits and retirement security for younger women or men.

Second, benefits under the Feldstein plan accrued disproportionately to high earners, mostly men. And third, the Feldstein plan undermines the long-term viability of Social Security as a social insurance program.

In conclusion, I would like to suggest that the President's plan, reserving 62 percent of the surplus and investing some Social Security reserves the way prudent pension managers would with special protections, provides a good framework for strengthening the system. There are also ways to improve Social Security to reduce poverty among older women, that I discuss in my testimony. One is the option of increasing the survivor's benefit, which was discussed by the representative from GAO. The other is to reduce the nearly 100-percent tax on Social Security benefits received by the poorest elderly people, those people who receive SSI, Supplemental Security Income, benefits, 73 percent of whom are women. There is only a $20 disregard for Social Security benefits in that program. It was set back in 1972. It has never been changed. It won't cost the trust fund a dime, although, as Chairman Shaw knows, his former Subcommittee would have to consider the consequences of that proposal.

In conclusion, I thank the Chairman and Members of the Subcommittee for focusing attention on these crucial issues.

[The prepared statement follows:]

Statement of Joan Entmacher, Vice President and Director, Family Economic Security, National Women's Law Center

Chairman Shaw and members of the Subcommittee on Social Security, I am Joan Entmacher, Vice President and Director of Family Economic Security of the National Women's Law Center. I thank the Chairman for calling this hearing, and for highlighting the importance of Social Security to women at the very beginning of the debate in this Congress. I appreciate the opportunity to testify before you today.

The National Women's Law Center is a non-profit organization that has been working since 1972 to advance and protect women's legal rights. The Center focuses on major policy areas of importance to women and their families including employment, education, women's health, and family economic security, with special attention given to the concerns of low-income women and their families. Most relevant to this hearing, the Center has worked for more than two decades on issues of Social Security and women. It has presented testimony on Social Security issues affecting women to Congress, the Advisory Council on Social Security, and several task forces of the Department of Health and Human Services. The Center served on the Technical Committee on Earnings Sharing in Social Security and co-authored its report, and served on the Congressional Study Group on Women and Retirement for the Select Committee on Aging of the House of Representatives, and co-authored and presented its Social Security recommendations.

Social Security's guaranteed, lifetime retirement benefits and family protections are especially important to women.

Social Security is important to the economic security of all Americans, but it is especially important for women. Women are not only a large majority of Social Security recipients 65 and older—60 percent—but also depend more on Social Security income for their basic economic security. Social Security accounts for more than half of the total income of widows and other women living alone, and is the only source of income for 25 percent of such women. Even with Social Security, elderly women still have a poverty rate nearly twice that of elderly men (13.1 percent v. 7 percent in 1997). But without Social Security, over half of all elderly women and over 60 percent of elderly single women would be living in poverty.

As Congress considers the future of Social Security, and proposals for alternative retirement programs, it is critical to remember that, especially for women, Social Security is not just a retirement program. In 1997, two-thirds of adult recipients of Social Security benefits were retired workers. The remaining third were disabled workers, spouses, surviving spouses, or disabled adult children. But the distribution of men and women between those two categories is very different. The overwhelming majority of male adult beneficiaries—82 percent—were in the retired worker category. In contrast, only 56 percent of adult female beneficiaries received benefits as retired workers. (This 56 percent includes "dually entitled" women who were eligible for retired worker benefits themselves, but received higher benefits as spouses.) Nearly half of adult female beneficiaries, 44 percent, relied on Social Security's disability and family protections. And these figures are just for adult beneficiaries—they do not include the nearly 4 million children who received benefits because a parent died or became disabled.

The announcement of this hearing correctly notes that several features of Social Security are particularly important to women. I'll briefly discuss why and how these protections are important to women; why they will continue to be important for younger women, despite their different work histories; why proposals to transform

Social Security, in whole or part, to a system of individual accounts—including the Feldstein proposal—pose inherent risks for women; and finally, I will offer some proposals for strengthening and improving the current system for women.

The current Social Security system includes several features of special importance to women.

- Social Security provides guaranteed, lifetime retirement benefits with a cost of living adjustment. This provides women, who on average have less pension income, lower savings, and a longer life expectancy than men, with a secure, basic retirement income, protected against inflation, for as long as they live.
- Social Security's progressive benefit formula provides women, and others who have worked for low wages, with retirement benefits that are a larger percentage of average lifetime earnings. For the median female retiree, Social Security replaces 54% of average lifetime earnings compared with 41% for the median male.
- Spousal and survivor protections are available on a gender-neutral basis—but it is overwhelmingly women who rely on these family protections. Social Security provides benefits to surviving spouses, and to the spouses of retired and disabled workers: over 98 percent of the recipients in these categories are women. In addition, Social Security allows individuals who are entitled to worker benefits on their own, and to benefits as a spouse or survivor, to receive the higher benefit. Currently, 63 percent of female Social Security beneficiaries receive benefits based on their husband's earning record; only 1.2 percent of male beneficiaries receive benefits based on their wife's earning record.

Social Security's protections will continue to be important to future generations of women.

Women today are working more and earning more than past generations of women. But their lifetime earnings, access to pensions, and ability to save, will continue to be less than men's for the forseeable future. In the past 25 years, some subgroups of women—especially those with a college education and beyond—have made significant gains in real wages. But many women still work in the same kinds of jobs their mothers did, and their real wages have been declining or stagnant until very recently.

The wage gap between men and women has narrowed over time, but it persists. In 1997, the median annual income for women in the labor force full-time, year round was $26,029—just 74 percent of men's.

While women's—and especially mothers'—participation in the labor force has increased dramatically over the last 50 years, mothers—especially of young children—are still more likely than fathers to work part-time, or be out of the labor force. In 1997, 60 percent of mothers with children under 6 were employed: 42 percent full-time, 18 percent part-time. In contrast, 93 percent of fathers of children under 6 were employed: 90 percent full-time, 3 percent part-time. Mothers of older children are more likely to be in the workforce, and to work full-time, than mothers of younger children: in 1997, 74 percent of mothers of children between 6 and 17 were in the labor force, 56 percent full-time, 18 percent part-time. But 91 percent of fathers of children 6 to 17 were in the labor force: 88 percent full-time, three percent part-time.

In addition, women today are much more likely than men, or than women of previous generations, to bear the extra economic burdens of caring for children alone. Between 1970 and 1997, the number of mothers raising children without a spouse in the home increased by 175 percent. And the economic problems faced by single mothers are great. In 1997, over 80 percent of single parent families were headed by women. Their median income, $17,256, was 40 percent less than the median income of single parent families headed by a man ($28,668). According to the latest figures available from the Census Bureau (for 1991), over 60 percent of custodial mothers, and over three-fourths of poor custodial mothers, received no child support. In 1997, collections were made in only 22 percent of the cases in the child support enforcement program.

Women's caregiving responsibilities—and the impact of caregiving on women's employment—are not limited to childrearing years. A recent survey reported by the National Academy on an Aging Society found that women represent nearly three-quarters of persons providing informal, uncompensated care for people 50 and over. These caregiving responsibilities affect their work: 49 percent have had to make changes in their schedules, 11 percent have had to take a leave of absence, 7 percent have had to take a less demanding job, and some have to leave the workforce entirely.

The wage gap and different work patterns mean that women still have lower incomes than men of the same age. In the 15–24 age group, women's median income is 85 percent of men's. In the 25–34 age group, it drops to 68 percent. In the 35–44 year age group, women's income is 57 percent that of men; in the 45–54 age group, 55 percent; 55–64, 46 percent.

Although a higher percentage of women in the future will receive Social Security benefits on their own earnings record, Social Security's family protections still will be more important to women than men in the decades ahead. In 2060—when today's 6 year olds will be eligible for retirement, assuming the normal retirement age is not extended further—the Social Security Administration projects that the percentage of women receiving benefits based on their own earnings history will have increased from 37 to 60 percent. On the other hand, 40 percent of women still are expected to receive benefits based on their husband's earnings history—if that option is still available.

Lower incomes, and especially heavy economic burdens for the much higher percentage of women than men that spend time raising children alone, means that many women have less ability to save for retirement than men. And despite their increasing years in paid employment, women will still be less likely than men to qualify for pensions. Most working women—about 55 percent—have jobs in service industries or the retail trade where pension coverage is less common than in predominantly male manufacturing jobs. And part-time jobs and interrupted work histories mean fewer women than men will qualify for pensions, even if their employers offer them.

Women's life expectancy is expected to increase, as is men's—but the gap will persist. So the risk of outliving any other assets will be continue to be greater for women. And because, on average, husbands are older than wives, women in the future still face more years living alone, on a reduced income, without a spouse to provide informal care.

In announcing this hearing, Chairman Shaw stated: "Women make great sacrifices for American families at home and in the workforce every day." That statement is as true for younger women who struggle to balance work and family responsibilities, and pay a substantial economic price for doing so, as it is for older women who were more likely to be full-time homemakers and caregivers. And it means that younger women, too, will be at much greater risk by any changes to the system that undermine Social Security's guaranteed, progressive, inflation-protected lifetime retirement benefits and family protections, whether through a system of individual accounts or otherwise.

Reducing or undermining Social Security's protections poses inherent risks for younger and older women.

Most individual account proposals would divert a portion of payroll taxes away from the Social Security trust fund into individual accounts. In exchange for reductions in guaranteed benefits, they hold out the possibility that the individual account will provide a higher return than Social Security. But the odds of this happening are stacked against women.

In contrast to Social Security's progressive benefit formula, benefits from individual accounts are directly related to the size of the individual's contribution and the return on investment, minus administrative costs. Lower earning workers, such as women, have less to invest, and much less that they can afford to put at risk. Administrative costs are likely to consume a higher portion of their savings. Some sort of a "safety net" for the lowest earners could be devised; however, the "safety net" benefits that have been suggested would be lower than benefits under the current structure for most women. And history suggests that safety net benefits would be much more politically vulnerable than Social Security's integrated, progressive, social insurance approach.

Proponents of individual accounts have stated that they would be "the property of each investing worker." Such statements should—and do—give women pause. Would "investing workers" be required to provide protections for spouses? Surviving spouses? Divorced spouses? Children? When individual accounts are being portrayed as individual property, are such requirements politically feasible? And even if account holders were required to make provision for joint and survivor annuities, how substantial would these benefits be? Under Social Security, the cost of providing benefits for spouses and survivors is widely shared. How many workers would save enough to provide family protections comparable to Social Security's, especially for the families of workers who die or become disabled at a relatively early age? If workers are encouraged to consider these accounts as individual property, how long will it be before Congress permits them to access their individual accounts before retirement, as they can their IRAs and 401(k)s? What would the consequences be for their basic retirement benefits—and their families'?

Because women are expected to continue to live longer than men, they will be especially hard pressed to obtain through the market the lifetime protection that Social Security provides. Lifetime annuities can be purchased. But converting to an annuity—which is done all at once—makes a woman's lifetime retirement benefits extremely sensitive to the state of the stock market at the time of the conversion. In addition, the costs of converting savings to an annuity are high. Economist Henry Aaron estimates that overall, 30 to 50% of the savings in an IRA or 401(k) individual account converted to an annuity are lost to administrative and management fees and the cost of conversion. Few private annuities are indexed for inflation. And most private annuities—unlike Social Security—base monthly payments on gender, providing women with lower lifetime benefits even when their investment is equal to men's.

Although the Feldstein plan purports to maintain the current benefit structure, it too poses serious risks for women.

The latest proposal for making individual accounts part of Social Security was developed by economist Martin Feldstein. It promises to maintain the current benefit structure, and provide additional retirement income to most retirees, without raising taxes. Sounds too good to be true—it is too good be true, especially for women. There are three major problems.

- The costs of the Feldstein plan fall disproportionately on women.

Unlike other individual account proposals, the Feldstein plan promises not to reduce guaranteed benefits. But women should not depend upon this promise.

How is this plan to be paid for? In the short run, the Feldstein plan is financed by taking all, or virtually all, of the projected unified federal budget surplus to finance the contributions to individual accounts. That poses particular risks for women's retirement security.

The economic security of older women, to a greater extent than older men, depends not only on Social Security, but on adequate health care coverage. Compared with men, elderly women will spend more years living with a disability, are much more likely to need long-term care, and already spend a higher proportion of their income on medical costs. The President has proposed reserving 15 percent of the unified budget surplus to support the Medicare trust fund—that wouldn't be an option if the Feldstein plan were adopted. Deeper cuts in health benefits, more cost-shifting to beneficiaries, a delay in the eligibility age for Medicare: these would be the available options, and all hurt women more than men.

Using all the projected surplus to fund the individual accounts proposed by Feldstein has other consequences for women. It means that other programs of special importance to women, including education and child care, would face budget cuts.

And, in the long run, even projected surpluses will not be enough. CBO and Social Security actuaries reject the claim that the program will ever be self-financing. In the future, when surpluses disappear, sustaining the program will require benefit cuts, tax increases, or a lot of deficit spending. This is not a way to offer retirement security to younger women—or men.

- Benefits under the Feldstein plan accrue disproportionately to higher earners—disproportionately men.

Economists Henry Aaron and Robert Reischauer estimated the returns to low and high earners under the Feldstein proposal, making the optimistic assumption that low and high earners would obtain the same rates of return on their individual accounts.

Wage Earner	Average Monthly Earnings	Social Security Benefit under Current Benefit Structure	Monthly Income from Private Account	Social Security Benefit After Offset	Total Pension Income	Overall Change in Pension Income
Low Earner	$1,000	$560	$240	$380	$620	+$60/+11%
High Earner	$5,600	$1,375	$1,340	$370	$1,710	+335/+24%

(Source: Center on Budget and Policy Priorities, The Feldstein Social Security Plan, December 15, 1998, Table 1, based on Aaron and Reischauer, Countdown to Reform (1998), p. 127)

As the table shows, the gains for high earners—disproportionately men—would be five to six times as great as the gains for low earners—disproportionately women, and more than twice as high in percentage terms.

- The Feldstein plan undermines the long-term viability of Social Security as a social insurance program.

The Feldstein plan is financed by reducing Social Security benefits by $3 for every $4 in income provided by the individual accounts. This could be viewed as a 75 percent tax. The consequence of this approach is—as the table above shows—that high earners, who contribute more to Social Security, would appear to get smaller Social Security benefits, in absolute dollar terms, than low earners. It is hard to imagine that such a situation could endure for very long. High earners would demand a lower tax rate—the right to keep more of "their account" (even though contributions had been financed by the budget surplus). If a future Congress responded, then the promised benefits to lower income beneficiaries, disabled workers and family members would have to be cut—with potentially devastating results for women.

Protecting and Improving Women's Economic Security in Retirement.

• To protect the economic security of women now and in the future, Congress should preserve and strengthen the Social Security system.

The President has made two proposals that are projected to extend the solvency of the Trust Fund for an additional 23 years, to 2055. First, the President has proposed dedicating 62 percent of the projected budget surplus—about $2.7 trillion dollars—to the Social Security Trust fund. Second, the President would allow a portion of what are now substantial Social Security reserves to be managed more like a prudent pension fund would be—by diversifying the investment portfolio beyond Treasury bills to include some equities, with special protections to assure the independence of investment decision-making. This would permit the Trust Fund to benefit from the projected growth in the stock market over time, without exposing individual investors to market risk.

As the President acknowledged, these proposals do not fully resolve Social Security's long term financing issues. But they substantially narrow the gap, meaning that smaller adjustments in taxes and/or benefit levels will be required to bring the system into long term balance. That is especially important to women. And as you consider such adjustments, we urge you to consider carefully the impact of the proposals on women, and other groups that are already disadvantaged. For example, reducing the cost of living adjustment below the Consumer Price Index would have the greatest impact on people who live longer—i.e., women—who already face an increased risk of poverty in extreme old age. Raising the payroll tax rate imposes a heavier burden on lower wage workers, including women. Increasing the number of years used to calculate benefits would disadvantage women, because they are more likely to spend time out of the work force for caregiving. Raising the retirement age further would pose additional hardships for many older women. Many women work in physically stressful and demanding jobs; a reduction or delay in benefits for women, who have less other income, is more of a hardship than for men. And while many older women would be able and willing to continue working, they face greater discrimination and caregiving responsibilities that can interfere with their ability to work. There are other, fairer, options this Subcommittee should consider to extend the solvency of the Trust Fund, such as increasing the amount of earnings subject to the payroll tax cap.

• Adjustments can be made within the framework of Social Security to reduce poverty among older women.

Over the years, the Social Security system has evolved to provide better protections for all Americans—especially women. Initially just a program for worker retirement benefits, family benefits were soon added, then benefits for disabled workers and their families. The automatic cost of living adjustment legislated in 1972, and the 1977 reduction in the duration-of-marriage requirement for ex-spouses to qualify for benefits (from 20 to 10 years) significantly improved the financial situation of older women. This Congress can and should make changes, within the framework of the existing system, to reduce poverty among older women.

Poverty rates vary greatly among different subgroups of women. Poverty rates for married women, who represent 43 percent of women 65 and over, is less than 5 percent. Poverty rates for women living alone, nearly 80 percent of whom are widows, are much higher—around 20 percent—and are higher than for similarly situated men, though widowed and divorced men also experience higher rates of poverty than married men.

There are several options Congress should consider to reduce poverty among the elderly, especially women. The most significant would be to increase the survivors' benefit as a fraction of the combined income of husband and wife; for example, to 75 percent of the combined benefits of husband and wife if that is greater than 100 percent of the benefit of either.

The major reason for the increase in poverty at widowhood, empirical studies indicate, accounting for 50 percent of the difference in poverty rates between married women and widows, is the decline in Social Security benefits at widowhood. While both the husband and wife are living, they receive two benefits: the husband's worker benefit and the wife's benefit, either her own earned benefit or 50 percent of the husband's benefit, whichever is larger. Upon widowhood, the survivor receives the larger of her own benefit or her husband's benefit, whichever is larger. For couples in which the wife was receiving the 50 percent spousal benefit, this means a 33 percent drop in Social Security income. For couples receiving equal benefits, because they had similar work histories, widowhood means a 50 percent drop in Social Security income. Increasing the survivor's benefit to 75 percent would benefit both groups, but would have its greatest impact on two earner couples. Thus, in addition to alleviating poverty among surviving spouses, this change would provide greater equity for two earner couples.

Second, Congress should reduce the nearly 100 percent tax imposed on the Social Security benefits earned by the poorest recipients. The Supplemental Security Income (SSI) program (which is separate from the OASDI trust fund) provides a safety net for poor elderly, blind, and disabled people. However, in calculating eligibility and benefit levels for SSI, only $20/month of the Social Security benefits they have earned is disregarded. The rest of their Social Security benefits simply reduces their SSI benefits dollar for dollar: an effective 100 percent tax on Social Security benefits over $20/month. The $20 disregard was set back in 1972, and has never been changed. Adjusting it for changes in the Consumer Price Index since 1972 would bring the disregard to $78.50/month. This approach effectively targets poor older women: 73 percent of elderly SSI recipients are women. It represents no cost to the Social Security trust fund, though it does affect the rest of the budget.

In addition, there are various rules that disproportionately impact certain groups of women. For example, the government pension offset rule, which applies regardless of the size of the government pension or Social Security payment, disproportionately hurts women who have smaller pensions and benefits. The earnings test, applied regardless of prior work history, falls especially heavily on older women who return to the workforce after many years of caregiving (President Clinton has suggested eliminated the earnings test altogether).

In addition to these adjustments within the Social Security System, Congress should:

• Consider ways to help lower income workers save for retirement separate from Social Security.

Social Security represents a secure basic retirement benefit, but was not designed to be the sole source of income in retirement. In recent years, Congress has created several tax-advantaged methods of saving for retirement—but many women and other lower income earners have been unable to take advantage of them because they have so little disposable income.

The President has proposed using part of the budget surplus to create new Universal Savings Accounts separate from Social Security. The concept is that a small initial contribution would be made by the government for most workers; additional voluntary contributions from low-income savers would be matched at a higher rate than contributions from higher-income savers.

The proposal has the potential for increasing retirement savings for women and others less likely to have savings, without jeopardizing the future of Social Security. However, it also raises serious questions.

• How much of the benefit of these expenditures will go to lower income people, and how much to higher income people? What are the short and long-term budgetary implications?

• Will the accounts only be for workers? What provision will there be for spouses, divorced spouses, survivors and children, and for persons who take time out of the workforce for caregiving?

• How will the accounts be managed? Especially for small accounts, how will administrative costs be minimized?

Finally, improving economic security for women in retirement involves even more than preserving and improving Social Security, preserving and improving Medicare, and promoting savings and pensions as sources of retirement income for women. It also involves improving economic security for women throughout their lives: promoting equal employment and educational opportunity, pay equity, higher minimum wages, child support enforcement, and assistance with caretaking burdens that fall especially heavily on women, including expanded child care and family and medical leave.

In closing, I want to again thank the Chairman, and the members of the Subcommittee, for focusing attention on the importance of Social Security to women, and on ways this vital program can be made even better.

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Chairman SHAW. Thank you.
Ms. Canner.

STATEMENT OF SHARON F. CANNER, VICE PRESIDENT, ENTITLEMENT POLICY, NATIONAL ASSOCIATION OF MANUFACTURERS, ON BEHALF OF ALLIANCE FOR WORKER RETIREMENT SECURITY

Ms. CANNER. Mr. Chairman, and Members of the Subcommittee on Social Security, I am Sharon Canner, vice president of Entitlement Policy with NAM, the National Association of Manufacturers. Today I am representing AWRS, the Alliance for Worker Retirement Security. Thank you for the opportunity to testify. The Alliance is a coalition initiated by the NAM. The Alliance is dedicated to representing workers in the reform debate.

AWRS is a growing coalition of over 20 organizations, including business trade associations representing large and small employers, corporate members, and other diverse groups. A list of the members and the principals is attached. The Alliance is dedicated to reforming the Social Security system to ensure an adequate retirement income for all workers and an opportunity for them to create personally owned economic wealth for personal retirement accounts. At the same time, we must maintain a safety net, a progressive, government-guaranteed benefits for all workers.

To set the scene, let me ask you for a moment if you would think about a woman who is the single head of household raising two children. She works two jobs all of her life, making an average of $20,000 a year. She works very hard and contributes 6.2 percent from her wages to Social Security for 45 years. At age 64, she dies. What happens to the thousands of dollars she has contributed? It is gone. Nothing is there.

Had she been living in Galveston, Texas, and I will cite that study, if she were a county worker contributing the same amount of money in a different kind of system, she would have received $350,000 upon her death. This is according to testimony that was recently given by Galveston officials. That $350,000 would then be passed to her children, which they could use to go to school or start a business. If she had lived into retirement, she could have gotten an annuity paying $2500 a month instead of the $621 average benefit that women beneficiaries receive.

The Social Security system has served us well and kept millions of women out of poverty. We must continue the insurance function of the system. At the same time, we have to modernize it, recognizing the changing demographics and changing lifestyles of women today. We have two key challenges, however, in this respect. Without changes to the system, women's benefits will be cut by over 25 percent. And I should say men's as well, given the Social Security deficits that will be approaching in 2032. For women living only on Social Security and retirement, as 7 million do, the average benefit, which is $621, would be less 25 percent. Can she afford that? Absolutely not.

The second challenge we face is that the system favors some women and is biased against others. AWRS believes there is a way we can solve both problems. We can ensure the financial security of elderly women by creating personal retirement accounts, and we can construct these accounts with provisions and safeguards for women's special needs.

How does the system favor some women and disadvantage others? Well, married women who do not work are nonetheless entitled to half of their husband's benefit or retirement even if she had never paid into the system. Plus, the retired couple could receive 150 percent of the husband's benefit. If either of the couple dies, that benefit, of course, drops down to 100 percent. The system discriminates against millions of married women who work outside the home under the dual retirement rule, that retired married women are entitled to a benefit larger based on their working years, or 50 percent of their husband's benefit, whichever is larger. With the personal retirement accounts, the same women could contribute to an account which they own, which grows as the economy grows, even while they are out of the work force raising children or addressing other domestic requirements.

In another example, the current Social Security system as we heard, rules, allows a divorced woman to similarly receive 50 percent of her husband's benefit or retirement, but only if that marriage has lasted 10 years. But I think as we know, recently statistics show that the median duration of marriages that end in divorce is now 7.7 years. Which means that more than half of those million divorced women will not get that 50 percent of their husband's benefit at retirement. Currently, this needs to be addressed. Personal retirement accounts with earnings sharing would have allowed these women to begin sharing in their husband's retirement earnings from day one.

And I ask you to consider the fact that has been mentioned earlier that women need the insurance aspect of Social Security, particular low income, and those that are divorced. After you consider that the Social Security system is going into deficit, and it is certainly a very risky system, we believe it would be much less risky for women to be able to set aside a part of their FICA tax in personal retirement accounts that would be put into index funds and fairly conservative investments that would earn them more income over time than they would get under the Social Security system, which now gives them a return of about 1½ to 2 percent.

The above examples point to the problems with the current system and the need to help women build retirement income. AWRS believes there is a way that we can solve these problems so we can ensure the financial security of our elderly women by creating personal retirement accounts, and we can construct these accounts for the provisions and safeguards for women's professional needs.

Mr. Chairman, we are pleased to work with you toward bipartisan reform of Social Security. Thank you for your attention.

[The prepared statement follows:]

Statement of Sharon F. Canner, Vice President, Entitlement Policy, National Association of Manufacturers, on behalf of Alliance for Worker Retirement Security

Mr. Chairman and members of the Subcommittee on Social Security, I am Sharon Canner, vice president of entitlement policy with the National Association of Manufacturers, and I'm here representing the Alliance for Worker Retirement Security.

We appreciate the opportunity to testify today. The Alliance is a coalition initiated by the NAM and dedicated to representing workers in the reform debate.

The NAM initiated AWRS because Social Security has been a top domestic priority at the NAM for several years. We believe that failure to adequately remodel Social Security would threaten the economic and retirement security of working men and women and American business. Without reform, the unfunded obligations of the government will do major harm to economic growth and jobs and make it extremely difficult for U.S. employers to compete in world markets.

The AWRS is a growing coalition of more than 20 organizations including business trade associations representing large and small employers, corporate members and such diverse groups as United Seniors, Citizens for a Sound Economy, Council for Government Reform and many others. The AWRS is dedicated to reforming the Social Security system to ensure an adequate retirement income for all workers and an opportunity for workers to create personal economic wealth—through Personal Retirement Accounts—while maintaining a progressive government-guaranteed benefit for all workers. (AWRS members and principles are attached.)

I'm here today to discuss women as participants in the current Social Security system and how women can become more financially secure in retirement. Let me begin by giving you an example: Think about a woman who is a single head of household, raising two children. She works two jobs her whole life making an average of $20,000 a year. She works very hard and she and her employer each contributes 6.2 percent of her wages to the system for 45 years. Unfortunately, at age 64, she dies. What happens to the thousands and thousands of dollars she contributed? It's gone. Zero. Nothing.

If she'd been living in Galveston, Texas, as a county worker, contributing the same amount of money into a different kind of system, she would have received more than $350,000 upon her death! This is according to recent testimony given by Galveston, Texas, officials at a Senate budget hearing. (The actual number is $383,000 at age 65.)

That $350,000 would be passed on to her children. They could have used it to go to school or started a business. If she had lived into retirement, she would have been entitled to an annuity paying $2,500 a month for life instead of $800 per month she would have received from Social Security—and that is if Social Security could pay its promises.

The Social Security system has served us well for over 60 years and kept millions of women out of poverty. We must continue this insurance against poverty with a guaranteed minimum benefit. At the same time, we must modernize the system, recognizing the changing demographics and the changing lifestyles of women.

The premise of AWRS is this: In spite of huge strides made by women in the past few decades, millions of women are still not able to achieve financial independence and financial security due to low earnings and interrupted work histories.

It is time that *all* workers—half of whom are women—be given a chance to create *real* economic wealth, independence, and retirement security.

The Social Security system should be reformed to allow a working woman to invest her payroll taxes in government regulated funds—that she can see grow over time. The existing system, even with it's bias towards some women, is running short of money. Women have the most to lose from this shortfall, and women have the most to gain from a system of Personal Retirement Accounts.

THE PROBLEM AND THE SOLUTION FOR WOMEN AND RETIREMENT SECURITY

It is well known that working women earn less than men and they take more years away from work while they are raising families or tending to other domestic needs. Likewise, women live longer than men and are more likely to be poor in retirement.

The Social Security system has helped lift millions of women out of poverty. It is critical that we continue to provide retirement security for the women in our society, especially women who are widowed, either as young mothers or in their later years.

Protecting the retirement needs of women requires that we face two key problems: First, we are facing huge revenue shortfalls in our existing system. Thus, those who are most dependent on Social Security "insurance" to keep them from falling into poverty—women—are at the greatest risk at this moment. Without changes to the system, their benefits will be cut more than 25 percent. If you are a woman living only on Social Security in retirement—and 7 million elderly people do—your average benefit now is $621 a month. Can you afford to have that cut by 25 percent? Absolutely not. That is the first problem.

The second problem is that our system favors some women, and because of demographic changes, is now biased against millions of other women. Any change we make to ensure financial security for our elderly must take these changes into account. In other words, as we fix the system, we must modernize it in order not to harm some women even more.

AWRS believes that we can solve both problems. We can ensure the financial security of our elderly women by creating Personal Retirement Accounts and we can construct these accounts with provisions and safeguards for women's special needs.

To begin, how does the system favor some women and disadvantage others? We all know that the system favors stay-at-home spouse, nearly all of whom are women. Because we value the work of women who stay home to raise a family, she is entitled to an additional 50% of her husband's benefits in retirement, even though she never paid taxes into the Social Security system. Thus, a retired couple receives 150 percent of the husband's benefit. When either of the couple dies, the benefit drops to 100 percent.

However, the system discriminates against the millions of married women who work outside the home. Under the "dual entitlement rule," at retirement these women are entitled to the larger benefit based on their working years, or 50 percent of their husband's benefit, whichever is larger. And, for a majority (about 60–70 percent) of women, the larger benefit is the latter. Thus, these women gained nothing by making Social Security tax contributions that they wouldn't have had otherwise. With Personal Retirement Accounts, the same women would contribute to an account that they own and that grows as the economy grows, even while they are out of the workforce.

In another example, the current Social Security rules allow a divorced woman to similarly receive 50 percent of her husband's benefit at retirement, but only if their marriage lasted 10 years. This rule was incorporated because legislators assumed that many women would be out of the workforce raising children during the early years, and should be compensated for those years. But, in the past few decades, we have seen the divorce rate skyrocket.

According to the U.S. Census Bureau, approximately a million couples divorce in this country each year, and the median duration of those marriages is 7.7 years. Thus, more than half of those million divorced women will not be entitled to a spousal benefit at retirement. Personal Retirement Accounts, with earnings sharing, would have allowed these women to begin sharing in their husbands' retirement earnings from the first day of their marriages.

Finally, consider the case of young widows. A woman whose husband dies before retirement is entitled to receive a benefit, but only if she has young children. If she has no children or her children are grown and her husband dies, she receives a grand total of $255 to bury him and then she has to wait until at least age 60 to receive a benefit.

I know a woman in New York named Joanne whose husband was a self-employed plumber, who paid the entire 12.4 percent payroll tax each year. Joanne stayed home to raise their two sons and worked a few part-time jobs. When she was 42 years old and her husband was 46, he dropped dead of a heart attack. Their children were grown and so she is entitled to no benefit from his Social Security for another 18 years! But now, at age 47, she is still trying to make enough money to get by and not have to sell her home.

If he had been able to put part of his payroll tax in a Personal Retirement Account, it would have been part of his estate, passing immediately to Joanne. She could have gone to school or start her own business or saved with that money. To this day, she is still trying to find out from the Social Security administration how much her husband contributed to the program during his 25 years of work.

Conclusion

To adequately provide for the retirement needs of women, we must acknowledge their special situations and assure their financial security. Fixing current rules is part of the solution. Beyond that, we must seek ways to enhance their retirement income. Personal Retirement Accounts are the means to do just that.

The Alliance is dedicated to reforming the Social Security system to ensure an adequate retirement income for all workers and an opportunity for workers to create personal economic wealth—through Personal Retirement Accounts—while maintaining a progressive government-guaranteed benefit for all workers. We are pleased to work with you and others in Congress toward bipartisan reform of Social Security.

—

Chairman SHAW. Thank you, Ms. Canner.
Ms. Leist.

STATEMENT OF MARILYN T. LEIST, MIDDLE ATLANTIC REGIONAL DIRECTOR, NATIONAL BOARD OF DIRECTORS, AMERICAN ASSOCIATION OF UNIVERSITY WOMEN

Ms. LEIST. It is Leist.

Chairman SHAW. Leist?

Ms. LEIST. Members of the Subcommittee, thank you for giving me this opportunity to testify today. My name is Marilyn Leist, and I come before you in several capacities. I am here, first of all, as a regional director on the National Board of the AAUW, American Association of University Women, the oldest and largest organization advancing equity for women and girls.

I am also here from a personal prospective, as a daughter, a mother, and a working woman, who cares deeply about protecting her family. Social Security is the Nation's foremost family protection plan, and I urge this Subcommittee to oppose any efforts to undermine protections for women and to support the administration's framework for strengthening and preserving the system.

Let me begin by telling you my own personal story. My 83-year-old mother, Lucy Thomas, worked 35 years as a waitress earning less than minimum wage. While at the same time, rearing two daughters and caring for my father as he became increasingly disabled with rheumatoid arthritis. Also, she cared for my grandmother, a farm woman, who had virtually no income for many years. As a waitress and a bartender, my mother and father barely made enough money to cover their daily living expenses. Thus, she does not have a pension, nor does she have income generating savings. Mother now depends solely on Social Security, $650 a month.

Although mother is a fiercely independent woman, she moved in with me at the age of 71 because she could no longer work outside the home to supplement her Social Security income. She has macular degeneration, a condition that has reduced her vision to shadows. While my financial situation is better than my mother's, the cycle is about to repeat itself when my husband, who has become increasingly disabled with psoriatic arthritis, retires. Just like my mother, I will continue to work. Although I have some savings, I was out of the work force for 8 years when my daughters were young. And like millions of other women, I currently have only a limited pension. I must continue to work not only to increase my retirement, but to pay for the additional cost of nursing care that may be required for my mother and my husband.

Social Security is my mother's lifeline in retirement. Like 87 percent of all elderly women, she doesn't have a pension. Her Social Security benefits, adjusted for inflation every year, are a predictable and secure source of income that she knows she can depend on for as long as she lives. This not only gives her peace of mind, it gives me peace of mind as well. That is why Social Security is so important.

We all pay into the system to ensure protection for our own and other's families. Social Security is a lifesaver for women, not only as retirement income, but as protection against so many of life's adversities. If we work at home or have low-income earnings, we can get benefits based on our husband's work records. We get widow's benefits and protections in divorce. And I can sleep easier knowing that if my daughter, my husband, or I, were to become disabled we could get disability coverage.

I've heard that some people think that one would be better off if Social Security were replaced in whole or in part by a system of individual accounts, where we would have our benefits cut in exchange for getting back some of our money to invest on our own in the stock market. That just doesn't make sense. What would happen if we invested poorly or if we had to retire just as the market spiraled down? We would lose out. And who would the burden land on? Our families. Now, that would be intergenerational inequity. We get all kinds of family protections from Social Security because the money is invested together, creating a universal insurance pool. If that money is put into individual accounts, those family protections would be jeopardized. Women would no longer get a widow's or spouse's benefit. Disability protections could be derailed, and divorced spouses would probably be left out all together.

I have heard administrative expenses could eat away a good portion of our benefits. This would change the system from Social Security to social insecurity. I am not an economist, but anyone who claims that individual accounts can be set up as part of Social Security without raising taxes or reducing benefits is not telling the whole story. Those plans will be very costly in the long run, and will undermine the integrity of Social Security.

AAUW would only support individual accounts that are kept totally separate from Social Security, that are aimed to help low- and moderate-wage earners, and that supplement the guaranteed benefits of Social Security, not undermine these benefits either now or in the future. We must keep in mind that Social Security is only one pillar of retirement, and that we must work to develop initiatives outside of Social Security to increase savings and pensions for women.

The 150,000 members of the American Association of University Women are so concerned about how Congress reforms Social Security that the issue is now at the top of our priority list. Our members understand that any reform that is enacted must keep the present system intact. AAUW does indeed look forward to working with the Subcommittee in developing proposals on Social Security, which are in the best interest of women, and in so doing, are contrite.

Thank you very much.

[The prepared statement follows:]

Statement of Marilyn T. Leist, Middle Atlantic Regional Director, National Board of Directors, American Association of University Women

Mr. Chairman, Members of the Committee, thank you for giving me this opportunity to testify today. My name is Marilyn Leist and I come before you today in many capacities. I am here speaking as a Regional Director of the National Board of the American Association of University Women, the nation's oldest and largest organization advancing equity for women and girls in education and in the workplace. I am also here from a personal perspective, to speak to you as a daughter, a mother, and a working woman who cares deeply about protecting my family. Social Security IS this nation's foremost family protection plan, and I urge this Committee to oppose any efforts to undermine protections for women and to support the Administration's framework for strengthening and preserving the system.

Let me begin by telling you my own story. My 83 year old mother, Lucy Elizabeth Thomas, worked 35 years as a waitress—earning less than minimum wage—while at the same time rearing two daughters, and caring for both my father, as he became increasingly disabled with rheumatoid arthritis, and for my grandmother, a farm woman, who had virtually no income for many years. Mother now depends solely on Social Security—on $650 a month. Although mother is a fiercely independent woman, she moved in with me at the age of 71 because she could no longer work outside the home to supplement her Social Security income. She has macular degeneration, a condition that has reduced her vision to shadows.

As a waitress and a bartender, my mother and father made barely enough money to pay for their daily living expenses. Thus, she does not have a pension, nor does she have income-generating savings. Her current income consists of about $8,000 a year from Social Security—she is one of the nation's elderly poor. Of that amount, $1,600 is used for secondary health coverage. Last year she paid an additional $1,000 in medical costs and another $1,400 for a hearing aid. In the fall, a bout with stomach ulcers forced her to pay over $200 for prescription drugs. I have purchased most of her clothing and paid for her room and board for the past 12 years. For many years Mother's identity and subsistence was closely tied to her productive function in the work force. Now Social Security is a real factor in her ability to survive with some dignity in her old age.

While my financial situation is a little better than my mother's, the cycle is about to repeat itself when my husband, who is becoming increasingly disabled with psoriatic arthritis, retires and requires attention from me, the caregiver. Just like my mother, I will be the provider and will not be able to stop working. Although I have some savings, I was out of the workforce for eight years, like millions of other women, when my daughters were young, and currently have only a limited pension. I will need to continue to work, not only to continue to shore up my retirement base but to pay for the additional costs of nursing care that will be required for my mother and my husband as they age.

Social Security is my mother's lifeline in retirement. Like 87 percent of all elderly women, she doesn't have a pension, and what savings she has, she's holding on to in case of an emergency. My mother's Social Security benefits, adjusted for inflation every year, are a predictable and secure source of retirement income she knows she can count on for as long as she lives. And this not only gives her peace of mind—it gives me peace of mind.

If this amount were reduced at all, what would she do? My own income is already stretched beyond capacity. It's because my mother gets a reliable stream of benefits that I can take her under my roof. Otherwise it would be a huge financial burden. That's why Social Security is so important—we all pay into the system to ensure protection for our own and others' families. Without a strong, solid Social Security insurance system, my mom and millions of other women like her would be living in poverty.

Social Security is a lifesaver for women, not only as retirement income but as protection against so many of life's adversities. If we work at home, or have low lifetime earnings, we can get benefits based on our husbands' work records. We get widows' benefits and protections in divorce. And I can sleep easier knowing that if my daughter, my husband, or I were to become disabled, we could get disability coverage.

I've heard that some people think that women would be better off if Social Security were replaced in whole or in part by a system of individual accounts—where we'd have our benefits cut in exchange for getting back some of our money to invest on our own in the stock market. This just doesn't make sense. What would happen if we invested poorly, or if we had to retire just as the market spiraled down? We'd lose out. And who would the burden land on? Our families. Now that would be intergenerational inequity.

We get all kinds of family protections from Social Security because the money is invested together, creating a universal insurance pool. If that money is put into individual accounts, those family protections would be jeopardized. Women would no longer get widow's or spouse's benefits; disability protections could be derailed; and divorced spouses would probably be left out altogether. I've heard administrative expenses could eat away a good portion of our benefits. This would change the system from Social Security to social insecurity.

I am not an economist, but anyone who claims that individual accounts can be set up as part of Social Security without raising taxes or reducing benefits isn't telling the whole story. Those plans will be very costly in the long-run and will undermine the integrity of Social Security.

AAUW would only support individual accounts that are kept totally separate from Social Security, that are aimed to help low and moderate wage earners, and that supplement the guaranteed benefits of Social Security—not undermine these benefits either now or in the future. We must keep in mind that Social Security is only one pillar of the retirement income system and we must work to develop initiatives outside of Social Security to increase savings and pensions for women.

Sometimes when I listen to this debate, I feel I'm in the Chicken Little story where everyone's screaming "The sky is falling, the sky is falling." But it isn't. There is general acknowledgment that Social Security is in sound shape for many years to come. Of course, it is important to act now to shore up the system for future generations. But we certainly do not need to dismantle the system. The Administration has proposed a framework which could help solve the funding issues while preserving the fundamental protections that are so important to women.

The 150,000 members of the American Association of University Women are so concerned about how Congress reforms Social Security, that the issue is now a top Association priority. Our members understand that any reform that is enacted must keep the present system intact. AAUW looks forward to working with the Committee in developing proposals on Social Security which are in the best interest of women—and, in so doing, the country.

Thank you.

Chairman SHAW. Thank you, Ms. Leist, and I apologize for mispronouncing your name.

Mr. Weller.

Mr. WELLER. Well, thank you, Mr. Chairman.

It is clear from the presentations made by the panel that we have six groups representing women. We have a wide diversity of opinion on solution, but I think we all share the common goal that we do want to save Social Security, and possibly, if we have an opportunity, in a bipartisan way to save Social Security for long term and keep it reliable for today's seniors that are currently on Social Security, as well as the X and Y generation that is just starting to enter the work force.

There are a couple of points that I think I would like to make before I ask a couple of questions, and where we have an opportunity, I think, for bipartisanship. I was very pleased when the President in his State of the Union speech endorsed an initiative as part of the Contract With America, and also has been an effort that has been led by our new House Speaker. That was the issue to eliminate the earnings limit on Social Security. Of course, Speaker Hastert has fought that fight, a good fight in the last few years, and we have made some progress, but I am pleased to see the President has embraced what Speaker Hastert has been pushing for years. So that is a bipartisan effort now, and I am pleased about that.

I am also pleased with what the President said regarding reserving 62 percent of the surplus tax revenue we now have from the balanced budget, to allocate that for Social Security. I might note that last year this Subcommittee, as well as the House, approved a plan which would have earmarked 90 percent of the surplus tax revenue for saving Social Security. So, at a minimum, we should certainly go along with what the President suggests, 62 percent.

The first question I would like to ask, and I would like to address to Amy Holmes, if I could. You noted in your testimony you are 25 years old, and you are one of those who feels that they cannot wait until you are 57 years old, and whether or not Social Security is going to be saved. But you talked about the need for saving for retirement.

One of the challenges that I find particularly difficult for working women, and I think of my sister, Pat, who had been a schoolteacher for some time. She and her husband decided to have children, and when the first child was born, she took time off from work to be home with the kids. And then when the kids were old enough for school, she went back to teaching, and that was a choice she made.

But, as we look at ways of essentially supplementing Social Security as well, you know, when Social Security was created it was to supplement your retirement and your savings and your pension. Many today consider what can we do today to supplement Social Security. Regardless, we want to encourage everyone to save. And one of the ideas that I have been an advocate of, of course, is what I call catch-up IRAs, where say, a working woman who took time off to be home with the kids like my sister, Pat, would be able to make up missed contributions to their IRAs when she returns to work. And I was wondering, is that an idea you think would work and do you have any suggestions on how we could make it work?

Ms. HOLMES. That certainly is something that we should all be considering, particularly when you look at the fact that a lot of women do choose to take time out of the work force. In fact, a 1992 census study showed that women were eight times more likely to take time out of the work force than men. So to be able to address this need in women's retirement, I think that is a very good idea. Again, earning sharing is another way so that women from the get-go are sharing 50 percent of their husband's retirement income.

Mr.WELLER. OK. I also have a question for Ms. Lassus. Did I pronounce your name correctly? It is Lassus?

Ms. LASSUS. Lassus.

Mr. WELLER. Lassus, excuse me. An issue that I have always had a strong interest in the Tax Code is, of course, the issue of the marriage tax penalty. Of course, working women tend to bear the brunt of it because you have a two-earner married couple, and because they filed jointly under our Tax Code, they pay higher taxes. Well, there appears from the information that I have seen in research that I have, there appears to be essentially a marriage penalty in Social Security where a two-earner couple receives less benefits than a one-earner couple with the same income, even though they may have paid more taxes. I was wondering what your thoughts and perspective might be on that as a businesswoman, and obviously, in a case where you and your friends may be in two-earner couples.

Ms. LASSUS. Certainly it is an issue. I think one of the things that we have always focused on is the safety net side of Social Security, and not really looked at the equity side in terms of the two-earner couples. There really needs to be something in the equation that allows us to build value. One of the ways to do that is through having individual accounts. It really provides a more equitable way of being able to build those dollars for the two-earner couples.

Mr. WELLER. OK. Well, thank you. I see my time is running out, Mr. Chairman. So, thank you very much. I yield back.

Chairman SHAW. Yes. Mr. Matsui.

Mr. MATSUI. Thank you very much, Mr. Chairman.

Ms. Entmacher, I would like to ask you some questions because you raised the Feldstein plan, and it has gone through a number of changes and alterations, but the basic structure is the same. I have a CBO study of August 4, 1998, and an update of September 17, 1998. It talks about the fact that the Feldstein plan would actually reduce national savings, and increase the deficit over time. But there is one aspect to the Feldstein plan that I am concerned about and that you touched on earlier—the disparity in wages. Feldstein proposes that 2 percent of one's earnings go into this pot or this so-called personal investment fund. That means, and correct me if I am wrong, but if a person makes $70,000 of annual income, that person will receive, well that person's entire work experience, $1,400 per year into that fund, 2 percent of $70,000. Whereas somebody that makes $20,000 a year would get approximately $400 a year into that annual fund.

Now, at the end of the process, Feldstein taxes the accounts by 75 percent. It will probably be the highest tax, it will almost be confiscatory, but he does tax those benefits up to 75 percent. But doesn't that increase the disparity that we currently talk about now between men and women because women make less than men? Is that a correct analysis of this as a general rule?

Ms. ENTMACHER. That is absolutely right. In my written testimony I include a table that was developed by economist Henry Aaron and Robert Reischauer that analyzes precisely the point you are making about the difference in returns to high earners and low earners under the Feldstein proposal, even after you make the tax adjustment that you are talking about. And what they find is that high earners, who are disproportionately men, would get five to six times as much return even after the tax adjustment, as low earners who are predominantly women.

The second concern about trying to recoup some of that tax, and the fact that so much more of the surplus that is used for these accounts goes to high earners, is that how long are people going to sit still for a 75-percent tax rate? Again, if you look at the table that is in my testimony, you can see that the end result of that tax rate is that high earners who contribute more to Social Security actually will get less from it than low earners do.

Right now, we have a system where it is progressive. Low earners get a higher percentage of their lifetime earnings, but high earners still get more and both groups can live with that. Under this system, it is hard to imagine that future Congresses aren't going to be lobbied to lower that tax rate.

The other thing that is likely to happen since this is portrayed as an individual account, is that people will want access to that account for emergencies, particularly women, as the point was made earlier. And just as with IRAs and 401(k)s, which were initially designed to be retirement savings vehicles, Congress over time will probably let people have access to these accounts. The problem is that even with all the surplus put into it, the funding, which depends on the 75-percent tax rate, totally collapses. Then we are in a situation either where benefits have to be cut very drastically, taxes have to be raised, or we have to start running major deficits again. It just doesn't add up.

Mr. MATSUI. If I can ask you a second question as well. Let us say that we do have a proposal to carve out 2 or 3 percent of the current 12.4 percent. One thing that hasn't been talked about is transition cost, the unfunded liability. I understand that some say it is up to $8 trillion, but others say it could be as low as $3 trillion and perhaps up to $8 trillion, none of the proposals would take into consideration how we fund that. That is the first question. The question is assuming we have a carve-out for low- or moderate-income people, many of whom are women, probably predominantly women. Also, I have been hearing that at the end of the process up to 20 percent of the total fund would be taken out over time in administrative costs.

Second, what kind of built-in protections could be made to make sure that, as we saw in England, we don't have a fraud and abuse problem. There has to be some kind of built-in system of protecting folks from, you know, the investment counselor who may not be quite an investment counselor?

Ms. ENTMACHER. Well, let me address those two questions separately. The first issue of administrative costs is, of course, a much bigger issue for people with small accounts.

Mr. MATSUI. Right.

Ms. ENTMACHER. And the small business owners probably know that if they tried to arrange a 40l(k) that is a nonprofit plan for their employees, those employees may be charged flat administrative costs on each account of between $40 and $65. It is very common.

In addition, the various funds that you invest in may take a percentage of the money in your account, commonly, 1 to 2 percent. So, if you consider somebody, let us say a $20,000 a year earner who puts 2 percent of their earnings into one of these individual accounts, that is $400, let us say they have a fabulous year with their investments, 15-percent return, which is really, really good. That is $60. If the management fee for that account, if the flat fee is $40, most of that gain has disappeared. When you add or subtract the 1½ percent of that $460, it drops still further. And obviously, if you do the math on a 10-percent return on investment, which is very good, the numbers are even more dramatic. So, that is one type of administrative cost that is worse for low earners.

The second type of administrative cost and expense is one that is particularly a problem for women. And that is the expense of converting a lump sum account. Let us say a woman retires with money in her account and she wants to buy an annuity. She wants to get in the private market the same kind of protection that women get now from Social Security. Well, for one thing, the current private market really doesn't give her that option. Because in the current private market, annuities with inflation protection are virtually unavailable.

The second problem she encounters in the private market is that gender-neutral annuities are virtually unavailable. Most private companies that sell annuities discriminate on the basis of gender. A man and a woman who walk in with the same pot of money, the woman is going to walk out with a lower monthly benefit because the company says we expect you to live longer, so we have to pay you less each month for our accounts to balance. And the costs of that conversion are particularly high because the annuity company says if you are coming in to buy an annuity, you probably think that you are going to live longer. It is a problem of adverse selection. Companies think that the people who buy annuities are people whose parents lived to 90 and beyond. It is a reasonable assumption, but it means that there is an extra penalty put on that, so the cost of transforming these accounts into the kind of social protections that Social Security gives are very high.

As to the regulation issue that you raised, it is a very serious one, it has been a serious problem in Britain, but I really don't have any observations on it.

Mr. MATSUI. Ms. Canner, would you like to comment?

Ms. CANNER. If I may, on administrative costs. There have been a number of studies that are looking at the administrative costs and are looking at experiences in other countries, such as Australia, such as Singapore. But looking at this country, some actuaries and consulting firms have indicated that because there will be so many accounts involved, and we are talking about potentially 140 million accounts, there will be such competition for this business. Thus, the management and administrative costs would come down.

Social Security, when it began in 1935, had fairly high administrative costs. Those have come down over the years, as we know. With respect to the very small personal retirement accounts, which I think is an issue, there could be some cross-subsidization from individuals who are putting in a lot more money. General revenues could be used for this purpose since it is a public good to have the government pay for the administrative fee.

On the last point about individuals who are putting in very small amounts into their personal retirement accounts, we could vary this. Perhaps, we could allow people at low income to put in a little bit more with some subsidization from general revenues. This strategy could encourage individuals of low income to try to match what the Federal Government puts in. So, I think this is doable if we think creatively about personal retirement accounts.

Chairman SHAW. OK.

Mr. Doggett.

Mr. Levin.

Mr. LEVIN. Thank you. Let me ask you about your written testimony that we are all trying to be sure that we learn and understand the way the present system works and proposed systems would work.

You say that the system discriminates against millions and millions of married women who work outside the home. Now, right now as you have described earlier, essentially a spouse who stays at home, gets a credit for part of that time because it is usually that she gets 50 percent of her husband's benefits. So, essentially we have a system which says for the stay-at-home mom usually, we are going to provide—the system reflects the work that was done by her, right? It is essentially the system.

Now you then go on to say that for the person who worked, if 50 percent of her husband's benefit is larger, she takes that and gets no credit for the Social Security payments that were made by her and her employer. In simple terms, that is what you are saying, right, and you conclude that that is discrimination.

I am not sure that that is a fair description. What is happening is, in a sense, that women who work in part are subsidizing, if you want to put it that way, are helping to pay for a benefit for the women who do not work. Now, I am not sure that is discrimination, number one. Number two, if we go over to a system of individual accounts, what happens to the woman who doesn't work? She, when she retires, gets nothing under that system, right?

Ms. CANNER. We will still maintain a safety net with some of the same rules, and improve others.

Mr. LEVIN. How would you do that? Who would pay for that for future retirees?

Ms. CANNER. Well, we have the insurance system which people continue to pay into with their FICA tax into the system to support it.

Mr. LEVIN. You would maintain—but I don't see how that quite works. You, and maybe I don't understand it fully, but if you allowed people to use their payroll tax and place it in an individual retirement account, that is what the couple would get. Are you saying that the spouse who has the individual retirement account gets it all, and the spouse who did not work gets 50 percent or something or other?

Ms. CANNER. Well, I don't think we differentiate. If you have a married couple reaching 65 or 62 and they collect benefits, they would get the normal defined benefits that they now get under Social Security, which may be adjusted. On top of that, they would get the personal retirement accounts. We are not going to discriminate if the woman didn't pay into that at all. What we are talking about is increasing that overall benefit for the married couple and for individuals.

Mr. LEVIN. So, under your system, none of the payroll tax would be used for personal individual retirement accounts?

Ms. CANNER. No. What we are saying is to take, for example, is to take 2 percent of the FICA tax and——

Mr. LEVIN. You say 2 percent. You mean 2 percent of what? It is more than 2 percent. I mean, it is 2 points of the overall payment, whatever that might be at the particular time.

Ms. CANNER. Well, if it is—we have 12.4-percent payroll tax.

Mr. LEVIN. So, it is 2 which is 6, more or less.

Ms. CANNER. Which is the employer-employee, 2 percent. We can do, you know——

Mr. LEVIN. Two points, that is 6, more or less.

Ms. CANNER. Yes.

Mr. LEVIN. OK. Now, what happens when both retire and the wife hasn't worked at all? Under your system, what would they get?

Ms. CANNER. The way the rules operate, they would still get the defined benefit—and then the personal retirement on top of that. It would be an enhanced benefit, so they would have more income coming in. It is basically the reason we are doing this is because the Social Security system by 2032 is going to be able to pay only 75 percent of promised benefits. What do we do? We increase taxes, which I don't think it is a choice that anybody wants to do. Or do we decrease benefits? None of these is a very good choice.

Mr. LEVIN. All right, well, I know my time is up, but I am not sure it is fair to say that it is discrimination when you give the married woman the benefit of half of her spouse's income if it is larger than what she worked. There is subsidization across—there is a lot of subsidization in Social Security. It is a progressive structure, and a piece of the progressive structure in a sense is that all of us pay, women and men, are paying for a benefit for the spouse who did not work. That is because of a decision by our society essentially to give credit to the woman who worked in the house and often worked more hours than her spouse, but received no payment.

Ms. CANNER. We are not proposing to take away that benefit.

Mr. LEVIN. OK.

Ms. CANNER. What we are proposing to do, the great preponderance of women who do work and who do not essentially get credit for all of the payroll taxes they have paid in personally.

Mr. LEVIN. OK. Thank you.

Chairman SHAW. Mr. Tanner.

Mr. TANNER. Something Ms.——

Ms. ENTMACHER. Entmacher.

Mr. TANNER [continuing]. Entmacher, thank you. What you said spurred my question. Assuming from what I understood, assuming that a man and a woman have an individual account of some sort, and assume they reach age 65 or whatever, and they both have the same amount of money in that account, then there is a difference in the gender because life expectancy as to what they might receive in the private market if they purchased an annuity.

Ms. ENTMACHER. That is correct. That is what I am saying.

Mr. TANNER. Do any of you all have that addressed in your plans for these individual accounts?

Ms. Canner.

Ms. CANNER. I think the point was well made that the annuity market doesn't really recognize the differences in the types of annuities that we might need if we had personal retirement accounts. I would submit that we have a very creative private sector and that there would be developed products out there. We are just really in the beginning of this discussion. I acknowledge that there isn't that much out there now, but I think that is a good positive step.

Mr. TANNER. Well, don't you assume that men are going to either live longer or women are going to die sooner if you make that statement, I mean——

Ms. CANNER. I mean, the problem is——

Mr. TANNER. Private enterprise is not in the business of, as far as I know and I have been in the insurance business, if I think you are going to live and statistics prove that you are going to live longer than your husband, I am not going to give you the same bill on a monthly basis that I am going to give him.

Ms. CANNER. You know, there is a——

Mr. TANNER. I think. Yes?

Ms. ENTMACHER. Absolutely. There is no market solution to that.

Mr. TANNER. I mean this is business. This not a social agenda. This is just straight business in terms of annuities.

Ms. ENTMACHER. I mean Social Security deals with it by saying, OK, everyone is in the same pool, we adjust the cost across the whole population so that people in retirement get equivalent returns. That is possible to do if, through legislation, you create a great big insurance pool and share those costs. But the private sector would be——

Mr. TANNER. But that is a social policy not a business decision. The other is a business decision, pure and simple.

Ms. ENTMACHER. That is right. That is right. And unless nondiscrimination is mandated, as it has been for pension funds because for employer funds, there is a law against discrimination in employment. Employer pension funds have to figure out—and people who provide annuities in employer pension plans have to figure out—what is the risk of the total pool, share that adjustment out so that people get equal monthly benefits regardless of gender. It can be done, but you have to have a mandate that forces people within this pool to deal with it. And in the private market, those solutions just won't develop on their own.

The other thing I wanted to mention about the potential of the private market to lower administrative costs which was mentioned earlier, is that the reason that Social Security has such incredibly low administrative costs, unmatched by any pension system in the country, is that it doesn't have to manage where people's money goes each month and what choices they are making with where they are sending their contributions. Employers put the money in one lump periodically, every quarter, paid to the IRS, and the accounting of credits is done on an annual basis.

It is really inherently much cheaper to administer that kind of system that uses wage credits than it is to imagine every employer managing accounts. And I think the small business people should know. Employee Benefits Research Institute did a study of how costly it would be if individual employers had to figure out what to do with this monthly contribution that 1 month the employee wants it to go here, and 1 month the employee wants it to go there. If we did have earning sharing on top of that kind of individual system, so you had to figure out where the husband's share was supposed to go and the wife's share was supposed to go, it would really get complicated. Earning sharing and Social Security would be difficult enough, but if everyone is sending their own money where they want it to go, it is very, very complex.

Ms. CANNER. May I respond to that? There has been discussion of how the money would be disbursed, how it would be invested. One proposal is that for the employer, it essentially would be transparent. The employer would still send this amount of money to the Social Security Administration, which could then divvy it up and figure out from there, so that the employer is off the hook in terms of having to worry about all these different places that the money would go. He would not have to generate an investment statement.

The Federal Employee's Thrift Savings Plan, which is done on an agency basis, essentially was done by agency. There are some models there. You point to a very good plan, but we are concerned. NAM itself includes large and a lot of small employers, small businesses. The administrative functions of getting this to work are being worked through. But it is a very good point.

Mr. TANNER. I see my time has expired. Mr. Chairman, thank you.

Chairman SHAW. Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman. There has been a lot of conversation or some conversation at least about the Galveston plan and what is going to come out in the GAO report. I think Ms. Canner talked about the woman who would have received $350,000. First of all, let me ask this question. In some of the stuff that I have, those alternative plans, actually the employer/employee relationship was 13.9 percent, not the 12.4, is that correct?

Ms. ENTMACHER. I am afraid all I know about the Galveston plan is what I read in the USA Today. I will have to wait for the full GAO report to come out to really speak to the details of that plan. But, if you could pose some hypotheticals, I will try to speak to them, but I don't have much information about the details.

Mrs. THURMAN. One of the things they talk about in contrast to the Texas plan, Social Security retains its value as you grow old and what it says is because the benefits under the Texas plan are not indexed for inflation; their real value decreases as the individual grows older. I don't know if you have looked at that. I guess, this is going to be some of the findings.

Maybe another one was Social Security provide spousal benefits, which increases the couple's total income, while the Texas plan's joint and survivor coverage reduces the couple's monthly income. Ms. Canner, you look like you are ready to comment.

Ms. CANNER. But see, you could change the rules. I mean, it is how you set it up. The study was very interesting in that one of the criticisms of the Galveston plan was that the investments were too conservative, that the plan could have done a lot better if they had been a little more progressive in investment strategy.

Chairman SHAW. Will the gentlelady, and I would like to inject this because this has come up a couple of times. The General Accounting Office Report, which was asked for by the previous Chairman of this Subcommittee, Mr. Bunning, is in a preliminary draft stage. I would just like to not speculate what the final report is going to look like. I think anybody looking at the minutes of this particular hearing should be cautious to make a determination as to what is in the final draft or what is in the final report, as evidently the draft somehow has been leaked, rather extensively. It is not in its final state at this point. I just caution the use of that information.

Mr. MATSUI. But you are not suggesting we shouldn't use it because——

Chairman SHAW. I am not suggesting how any of the Members should ask the questions.

Mr. MATSUI. Right.

Chairman SHAW. I just want to be sure in looking at the minutes of this hearing that anybody——

Mrs. THURMAN. Well, Mr. Chairman——

Mr. MATSUI. Yes. And let me just say this. I realize it is in draft form, but the draft form is a document that is completed as a draft, and so I think it is legitimate unless they have a reversal of her opinion. So I am not suggesting that what you said is incorrect. I am suggesting that there is validity to it. I mean if the findings were in the opposite direction, I would imagine some others would have been saying the Galveston report is a good deal, and we would be saying it is a draft document. But there is value to it. There is some work that went into it, and the conclusions that were made were based upon reasonable analysis.

Mrs. THURMAN. And I thought what I was just talking about were some of the features, not necessarily the conclusions of the GAO. I mean, I was just trying to get to some of what has happened under the features part of it. But that's fine.

Chairman SHAW. I am not correcting. I am not correcting any of the Members. I just put in a couple of cautionary statements in the record.

Mrs. THURMAN. OK.

Ms. ENTMACHER. And if you would like, I think that the findings that have been reported are consistent with the predictions that people would make, which is that for women to achieve through an individual account—for any low earner, not just a woman, to achieve through an individual account—the kinds of long-term benefits, inflation-protected benefits, and minimum 50 percent spousal benefits and 100 percent of her husband's benefit continued indefinitely, that survivor's benefit, under Social Security, is much better than people get out of pensions. When a woman becomes a widow, the relative benefit that she gets as a widow under Social Security, even if her husband had a pension plan that had a survivor provision, that is going to much smaller than it is under Social Security. So, those reported results are entirely consistent with predictions that everyone has made.

I would point out, that the CATO Institute, when it did its study of privatization, and I have a lot of critiques about that CATO Institute study, even CATO concluded that if you are talking about a plan that diverts only a portion of investments for individual accounts, that most women lose. CATO makes claims that if you invest all of it and go for the full monty, as they have called it, then you can get gains. And if anyone is interested in that, I can talk about, you know, those issues. But, even they agree that if you are talking about allowing low-income people to invest just a small portion of money, women are going to lose.

Mrs. THURMAN. Can I ask Ms. Lassus a question? Since you have had some dealings with this in companies that you have worked with, what have been your management costs in those, as particularly as we relate to an individual account? What are we looking at in management costs?

Ms. LASSUS. I would like to answer that in a couple of different ways. I think the management costs are controllable. One of the ways they are controllable is by using index fund type of investments. The typical stock index fund that invests in S&P 500 stocks is less than one-half of 1 percent per year in management fees. So, there are many ways to manage those costs.

Mrs. THURMAN. Is that per individual or would that be through a corporation that you are working with?

Ms. LASSUS. It is a mutual fund. It is anybody that buys like a Vanguard 500 fund. That is the cost that is spread across the fund. Individual accounts, if you went out today and said, I want to have an account individually managed, there are going to be minimum fees involved. And most fees are structured anywhere from one-half of 1 percent per year up to 1 percent per year. But again, the only way this is feasible, and we talk about individual accounts, but you can have individual accounts accounted for. It doesn't mean they have to be individually managed. You can still manage with pooled assets and significantly reduce the cost of managing those accounts.

Mrs. THURMAN. I guess my time is up, Mr. Chairman. I have lots more questions.

Chairman SHAW. I think the analysts have done an excellent job in setting forth various problems that they see that this Subcommittee is going to have to tackle and have to deal with. I think that we have gotten a little bit off the point because I don't think anybody has suggested the individual accounts or government funding is going to solve all the problems, particularly, as to the women's issues, and that is what we are trying to bear down and concentrate on today.

We have had a very well-versed and well-prepared panel, which we very much appreciate. If I am reading everybody correctly, it seemed that everybody sees, with the exception of Ms. Coleman, who is viewing this as one of the older recipients of Social Security, that the other members of the panel feel that some type of private investment is proper whether it is individual accounts or whether it is the President's plan, but I have not seen any adversity to both. So, I think that at least gives us some insight as to the thinking of people that are very close to the problem that we are facing.

Our problem is going to be to solve some of these other issues, but I can assure you that we are very sensitive to the women's issues with regard to this, and the inequities with regard to this, and we will be struggling for some solutions. We have gotten some very good testimony today.

I want to thank each and every one of you for being with us. This hearing is adjourned.

[Whereupon, at 4:35 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of Hon. Rosa DeLauro, a Representative in Congress from the State of Connecticut

Yesterday, I introduced a resolution on the importance of Social Security, one of our nation's greatest success stories, to women. The resolution recognizes the unique obstacles in ensuring their retirement, survivor and disability security, and the essential role that Social Security plays in guaranteeing inflation-protected financial stability for women throughout their golden years. The bill calls on the Congress and the President to give these factors serious deliberation when weighing proposals to reform the Social Security system. I am very proud to have 96 of my colleagues join me in co-sponsoring this important piece of legislation.

Although they make up roughly half of America's population, women account for sixty percent of Social Security beneficiaries. Three-quarters of unmarried and widowed elderly women rely on Social Security for over half of their income.

Social Security's benefit structure has been exceptionally helpful to widows, who have a poverty rate nearly twice the overall poverty rate for older Americans. In fact, the median annual income for widows age 65 and older in 1996 was $10,518. For these women, Social Security provides widows' benefits equal to 100 percent of their husbands' benefits. This is especially important because women tend to outlive their husbands. As of 1996, at age 65, the average woman could expect to live more than 19 years than the average man.

Any changes to the Social Security system must be thoroughly researched and carefully considered to maintain Social Security's guarantee of financial stability in old age. As we begin to debate Social Security reform, Congress and the President must be committed to ensuring that any reform proposal protects and strengthens the financial security of women in their later years.

Statement of Lou Glasse, Carroll Estes, and Timothy Smeeding, Gerontological Society of America, Taskforce on Older Women Project

Social Security Reform and Older Women: How to Help the Most Vulnerable

Social Security and its impending reform is important to all Americans, particularly to women, its largest constituency. We see the impending Social Security reform package as an opportunity to improve economic security for older women, not just to achieve long-run actuarial balance in the trust fund.

Specifically, we want to focus on three groups of women who rely heavily on Social Security income as a source for their retirement income security:

- Women who enter retirement age unmarried (roughly 18 percent of those now aged 55 to 65).
- Women who enter retirement age as married (most of whom go on to collect benefits as widows, survivors, or retired workers, roughly 82 percent of those now aged 55 to 65).
- Much older single women, most of whom have been receiving OASI benefits for some time.

In our forthcoming report, we deal more generally with the impact of Social Security reform on older women, including issues related to privatization, benefit reductions, taxes, and other matters. Here we concentrate only on the specific issue of protecting vulnerable older women.

The facts on older women's reliance on OASI as their only inflation-protected benefit are well known. Still, we begin with a few of these, some of them very new, and all of them specific to the populations we seek to protect, in order to set the context for the discussion of reform options that follows.

I. ECONOMIC SECURITY AND OLDER WOMEN

The following facts are pertinent to our arguments for policy action on behalf of older women:

- Women make up over 60 percent of all Social Security beneficiaries. More than two in three persons age 75 and over are women. Because the fraction of the population 85 and over is the fastest growing age group among the old, their economic needs are of particular importance. Moreover, almost three in four persons aged 85 and older are women.
- Older women rely far more heavily on Social Security than do older men. And unmarried women (including widows, divorcees, and never-married women) rely on Social Security far more than do married women. Over 40 percent rely on Social Security for 90 percent or more of their incomes. On average, unmarried women receive 72% of their income from Social Security. This fraction rises with age, rises among older women living alone, and also rises as overall incomes decline. For instance, 80–84 year old widows with below median incomes rely on Social Security for more than 80 percent of those incomes.
- Consider the wealth status of nearly retired older women aged 51 to 61 and not their incomes, per se. These wealth accumulations present the estimated sum total support one can achieve from all of their resources if they draw them down consistently over their expected lifespans. If we take into account financial, housing, private pension, and Social Security wealth, we find that among the 18 percent of all women who are single, two-thirds are in the bottom three deciles within the wealth distribution (Table 1). And within these groups, future expected Social Security wealth is by far the largest component of their wealth. In contrast, only 25 percent of married women in this same cohort find themselves in the bottom 3 deciles. While their average wealth is much higher, again Social Security is the dominant form of wealth for these low wealth women (Table 1).
- These facts predict that older women live in a much less advantageous economic situation than do older men. In fact, three of every four poor elderly persons are women. Poverty rates are highest among divorced women, widowed women, and never married women—all about 20 percent—compared to a poverty rate of 5 percent for married women. Moreover, if we follow the National Academy of Science recommendations and adjust incomes for taxes, in kind benefits and for out of pocket expenses for health care, the poverty rate for all older women living alone rises

to 31 percent. Out out-of-pocket health care expenses act like a tax on their incomes, forcing low-income elders to choose between health care or food and housing.

• As times change and women's work histories improve, more women will collect private pensions and Social Security benefits based on their own earnings. But women will still interrupt their work careers far more often than men to parent their children and to care for their own elderly parents. At retirement age, Social Security benefits depend on the 35 highest years of earnings. Years with a "zero" are those where there were no countable earnings. We asked the Social Security Administration to tell us how men and women compared with respect to "zero" years for those who qualified for Social Security in 1997 (i.e., those aged 61 in 1996). They find that among women aged 61 in 1996—the next generation of women to retire—only 32 percent have no "zero years" of earnings as part of their 35 highest earning years (Tables 2 and 3), compared to 75 percent of all men with no "zero" years. Almost 35 percent of women have ten or more zero years compared to 12 percent of men. Hence, women continue to have interrupted work careers and will need to rely on their partners (married women) and former partners (divorced women) whose children they cared for and homes they kept during those zero years.

• In fact, the Social Security Administration projects that the percentage of all women beneficiaries who receive benefits based on their own earnings will rise only from 37 percent in 2000 to 56 percent in 2030. Nearly one-half of all elderly women will continue to rely on their husband's Social Security benefits. Future older women will rely more heavily on their own pensions, and hopefully, on their husband's pensions under joint and survivor's options. However, women are far less likely than men to qualify for private pensions (30 percent vs. 48 percent in 1994). Even when women do receive their own pensions, they qualify for benefits that are only about half the median benefits received by men. Finally, about one third of husbands still do not elect joint and survivor options for their private pensions upon retirement, despite federal legislation to increase such determinations, thus depriving one-third of widows of private pension support.

Table 1. Distribution of Women's Total Net Household Wealth for Women Aged 51 to 61 in 1992[1]

Decile	Percent Women	Percent of Decile[2,3]	Mean Wealth by Component[4] (in 1992 dollars)					
			Housing	Financial	Social Security	Private Pension	Mean Total Wealth	Percent of Total that is Social Security
A. Single Women								
Lowest	41.0	58.3	2,795	−243	46,259	1,737	50,548	0.92
Second	17.8	27.8	21,316	13,155	57,274	10,442	102,187	0.56
Third	9.8	17.9	46,140	27,068	62,758	17,380	153,346	0.41
Fourth	7.2	12.8	47,414	39,461	67,746	35,377	189,998	0.36
Fifth	4.8	9.4	64,144	61,664	73,412	35,175	234,395	0.31
Sixth	4.6	9.1	78,138	866,19	73,771	56,508	295,036	0.25
Seventh	4.3	8.1	82,260	100,457	77,158	78,907	338,782	0.23
Eighth	4.2	8.7	109,773	153,074	81,044	95,042	438,933	0.18
Ninth	3.1	5.8	104,194	208,675	89,212	168,469	570,550	0.16
Highest	3.2	7.2	163,015	571,325	101,456	225,539	1,061,335	0.10
Total	100.0	na	41,779	61,509	61,885	36,720	201,893	0.31
B. Married Women								
Lowest	4.4	23.0	–36,196	24,998	83,578	3,941	76,321	1.10
Second	9.9	57.8	13,971	7,700	116,326	7,609	145,606	0.80
Third	10.8	73.0	27,769	24,716	133,907	18,504	204,896	0.65
Fourth	11.2	82.0	47,924	34,885	146,395	31,456	260,660	0.56
Fifth	11.3	85.5	59,799	54,986	154,189	55,115	324,089	0.48
Sixth	11.0	85.0	71,211	78,616	156,943	83,836	390,606	0.40
Seventh	11.0	85.1	87,452	122,199	162,604	107,576	479,831	0.34
Eighth	10.4	85.7	977,797	170,723	169,926	163,860	1,482,306	0.11
Ninth	10.2	88.9	118,021	287,926	169,366	222,661	797,974	0.21
Highest	9.8	86.0	185,327	1,217,035	176,027	301,720	1,880,109	0.09
Total	100.0	na	78,963	229,506	153,660	113,423	575,552	0.27

[1] Deciles used are overall population deciles for wealth. HRS sample weights are used to make the sample representative of all men and women as of 1992.
[2] Number given is percent of decile which are single women. Single women can be divorced, separated, widowed, or never married. About 18 percent of this cohort are single women.
[3] Number given is percent of decile which are married women. About 82 percent of this cohort are married women.
[4] Wealth is the present discounted value of wealth as calculated in R. Burkhauser and R. Weathers, "Access to Wealth among the New-Old and How it is Distributed: Data from the HRS," mimeo. Ithaca, NY: Cornell University, November 1998.
Source: Health and Retirement Study (HRS), Wave 1, First Release.

Table 2. Distribution of Zero Years of Earnings in "High 35" Years in 1996:[1] A. Number of Workers Age 61 in 1996

Workers	Number of Workers	Of Zero Years
All	1,591,400	4.6
Men	865,400	2.5
Women	726,000	7.0

[1] The data were derived from SSA's Continuous Work History Sample, for living, nondisabled workers at age 61 in 1996. The data indicate the number of years in which no FICA earnings are present among the worker's highest 35 years of earnings.
Source: Alexa Hendley, Social Security Administration, Office of the Deputy Commissioner for Policy, February 2, 1999.

Table 3. Distribution of Zero Years of Earnings in "High 35" Years in 1996:[1] B. Percent of Workers with "Zero Years" by Gender

(35 highest years)

Number of Zero Years	Total	Men	Women
None	55.5	74.9	32.4
1 to 2	5.1	3.3	7.2
3 to 4	5.1	3.2	7.4
5 to 6	5.0	2.7	7.8
7 to 9	6.9	4.0	10.5
10 or more	22.4	12.0	34.7
Total	100.0	100.0	100.0

[1] The data were derived from SSA's Continuous Work History Sample, for living, nondisabled workers at age 61 in 1996. The data indicate the number of years in which no FICA earnings are present among the worker's highest 35 years of earnings.
Source: Alexa Hendley, Social Security Administration, Office of the Deputy Commissioner for Policy, February 2, 1999.

• Social Security benefits provide inflation adjusted income protection not found in other types of pensions (which are usually fixed in nominal terms and which therefore depreciate rapidly over the 25-year or longer period of older women's retirement lives). From December 1982 to September 1998, the Bureau of Labor Statistics experimental price index for elderly consumers rose 73.9 percent compared to a 63.5 percent increase in the official overall consumer price index used to adjust Social Security benefits for inflation. This difference was mainly because of higher costs for health care, especially prescription drugs.

II. Reform Options to Protect the Financial Security of Older Women

Clearly the facts reviewed above suggest that older women are at a true economic disadvantage compared to older men, in absolute as well as relative terms. Here we present a number of alternative measures that would protect the economic well-being of older women and provide a true floor to their incomes from Social Security. Our goal is to outline a set of strategies rather than to suggest one single strategy. While the survivors option estimate, 0.15 percent of payroll cost over the next 75 years, is well known and has been consistently priced out by several authors, there are no cost estimates for the other options suggested below. We expect that they will only be on the order of 0.10 percent of payroll. Still, in a situation which requires the closing of a 2.20 percent of payroll long-term gap between revenue and outlays, items that reduce poverty and provide a true floor to women's incomes at an estimated total cost of 0.25 percent of payroll, or less, do not place extravagant demands on systemic reform.

Policy Options for Survivors' Benefits

Survivors' benefits should be strengthened, not weakened by Social Security reform. Social Security survivors' benefits are the key feature of older women's economic well-being for the 15.3 years in old age the average female survivor spends as a widow. Survivors' benefits are crucial to the economic well being of spouses with lower lifetime earnings. Today 74 percent of elderly widows receive benefits based on the earnings of their deceased spouse. While this fraction will most certainly decline in the future, about half of widows will still depend largely on their husband's benefits in old age in 2030.

We are opposed to any plan which allows withdrawal of Social Security funds prior to retirement or which does not mandate considerable benefits for divorced or surviving spouses. We favor plans which would provide a lower initial spouse benefit upon retirement (to reduce costs) in return for a higher survivor benefit upon death of a spouse. The plan which reduces spousal benefit from one-half to one-third of worker benefits upon initial receipt, but which then raises spousal benefit for survivors to three-fourths of the couples, combined benefit is the option which we favor.

In fact, the President's proposal for Social Security reform, and older women, which is precisely this option, would go a long way toward helping women, who are married at the time of Social Security receipt, once they reach widowhood and survivor status. The President's proposal echoes the same recommendation made by the Advisory Council on Social Security in 1996 and by Aaron and Reischauer in their recent 1998 book on Social Security reform. The President's own White House document of October 27th presents a good introduction to the economic problems of older women, and we are pleased to see that he has followed up on them in his State of the Union Address and Budget Document. This proposal is sound policy and we heartily endorse it.

However these efforts still leave two types of economically vulnerable older women:

- Those who are not married at the time of benefit receipt: divorcees and separated older women(who are in the process of becoming divorcees), younger survivors, and never married women. Of this group (16 percent of women aged 51 to 61 in 1992), 60 percent were divorcees or separated, and only 12.5 percent were never married, the remaining 37.5 percent being women already widowed.
- Very old (aged 80 to 85 and older) single women who have simply outlived their partners, assets and savings. These women could be either women widowed at a young age or unmarried women. Both groups will have those who slip through the cracks and find themselves reliant on Social Security at very old ages.

Policy Options for Economically Vulnerable Older Women

Our policy goal is to provide economic support to vulnerable older women at reasonable cost and without creating a set of disincentives for economic self support. The incentive issue is far less important in the case of the very old women, but it may be relevant for relatively younger divorcees and relatively younger single women.

If we are to address benefit adequacy, we must begin by opposing any artificial reduction in the Social Security cost-of-living adjustment (COLA). If one takes a single percentage point away from a COLA every year and compounds the effect over 20 years, the beneficiary ends up with a cut of 22 percent compared to the current COLA formula. Over 25 years, the reduction is to 72 percent of the original benefit; and over 30 years to 65 percent of the original amount. Hence, an OASI recipient who elected to take a benefit worth 80 percent of his PIA at age 62, and who was married to a 60-year-old woman who subsequently became his widow in 20 years time at age 80, this woman has only 62 percent of the PIA as a social Security benefit. And if she lives to age 90, 30 years of dependence on the program, she has only 52 percent of the PIA. Thus, older women would end up with increasingly less from OASI with a lower COLA, when as time goes on, facts show that this is the asset on which they most depend.

Note also that over this same time period, a 1.5 percent per year increase in the overall average income of the rest of society would increase their incomes by 34 percent (over 20 years), or 56 percent (over 30 years), while older women's real economic security becomes less due to lower inflation protection. Even to hold constant income of the aged beyond retirement in real terms would have them fall increasingly further behind the income of the rest of the population, and a reduced COLA would compound this difference, leading to a lower real income at a time when the rest of society was becoming increasingly better off.

There are several alternative options that could better help address each of the problems we outline above, including the inflation protection option:

- A special minimum benefit or (enhanced COLA) for older long time beneficiaries, e.g., those 80+ years of age, or those with 20+ years of benefit receipt. This would bring their real income up to some fraction of the difference between their OASI benefit and the change in the incomes of the rest of society over this period.
- Indexation of elder OASI benefits to the elderly CPI developed by the Bureau of Labor Statistics. For $40.0 million per year, the BLS could provide an accurate elder CPI and in so doing increase equity across generations and provide true cost-of-living protected benefits for the most vulnerable elders, regardless of future cost-of-living increases.
- Institute a guaranteed poverty line benefit, about $600 per month at present, as recommended by the CSIS Social Security reform proposal, for those with 40+ years experience with the system. If we were to count a certain number of years

for time spent in raising each child, e.g., three years; plus years married to a former husband when he was paying into the system; plus own years worked, to get to this 40 year threshold (with concomitant reductions for those in the system for less than 40 years so counted), a universal guaranteed minimum benefit might be both target and cost effective.

• Institute a new income tested minimum benefit guarantee of $600 per month within the Social Security Act and separate from SSI, which gave credit to OASI recipients for a larger share of their OASI benefit than does SSI(or more than the current $25 per month). The program would have a guarantee of $600 per month for beneficiaries with less than $400 per month of OASI benefits; provide a slightly lower than $200 subsidy for those with higher OASI benefits ($400 or more); and would then phase-out to zero for those receiving $750 per month (roughly 125 percent of the poverty line). All other sources of income would be taxed at 100 percent by this program. Because the system was run by the Social Security Administration as part of their regular operations, no stigma or take-up problems would arise as long as the beneficiary filed income taxes the year before. And such a system would benefit only those who qualify for Social Security to begin with. One could think of this as a targeted minimum benefit. Canada has had great success with a system similar to that above, instituting a Guaranteed Income Supplement (GIS) to provide minimum benefits in old age. The program resulted in reducing their older single woman poverty rate from 21 to 8 percent over ten years. And we could also have a similar success.

• Reform SSI for elders so that the guarantee was increased from 77 to 100 percent of the poverty line (i.e., to $600) for elders who are Social Security beneficiaries, with a much higher liquid assets test and with the same disregards as the current system. The program would require that recipients apply to the program, hence risking take-up and stigma issues, but would otherwise approximate the structure of the previous program.

III. Conclusion

Great advances have been made in improving the retirement income for most older people. But millions of older women who live alone have not been able to enjoy improved security. Current inequalities in incomes and assets have not declined with the continuing economic boom. And divorce rates continue to climb among older and middle age women. Hence, it makes sense to pay a modest price to build an effective income floor into the OASI system to address this problem as we restore actuarial balance to the system. Older women deserve such a commitment. The committee should urge the Social Security Administration Deputy Commissioner for Policy to estimate the costs and benefits of each of these five options and report their findings to Congress. If economic growth, private pension accumulation and asset accumulation continues amongst the future elders, all of the population, men and women alike, might look forward to an economically secure old age. Until this happens, steps must be taken to assist those who are most vulnerable. But we doubt that this will be the case.

Statement of Heidi Hartmann, President and Director, Institute for Women's Policy Research; and Chair, Working Group on Social Security, National Council of Women's Organizations

I would like to share with the Committee on Ways and Means my analysis of proposed reforms and suggestions for Social Security changes that would benefit women. This summary is based on the statement I submitted to the White House Conference on Social Security, held on December 8. I have also briefly addressed the proposal the President put forth in his State of the Union speech on January 19. Following my statement and a fact sheet from the Institute for Women's Policy Research is the statement of the working group on Social Security of the National Council of Women's Organizations.

Social Security is a Women's Issue

Sixty percent of Social Security recipients are women. Women are not a side issue in the debate over how best to finance the current system and whether to replace it partially or totally with a system of individualized private accounts or to add-on subsidized voluntary savings accounts. Women are central to the debate. Women's views on financing and benefits are critical to the President's and Congress's ability to pass legislation changing Social Security in 1999 or any other year.

Why Individual Private Accounts or a Substitute for Social Security Won't Work for Women

Women are extremely skeptical that steering payroll taxes into individual private accounts will work for them to provide sufficient security in retirement. Women have lower earnings and live longer than men on average; therefore they have to stretch a smaller income over more years. They save less and have much less access to employment pensions. The security of Social Security as it's presently configured—the life-time guaranteed benefits, the higher returns for lower earning workers, the cost of living adjustments, and the spousal benefits (including benefits for widows and divorced women)—is critical to women. None of the privatization plans put forward provide all these assurances to women.

Moreover, any transition to a system of pre-paid retirement benefits (saving while working to pay for retirement later) while the current pay-as-you-go system is still in place (today's workers pay for today's retirees' benefits), requires the transition generations to pay for two systems at once. This either requires more taxes or other sources of revenue to support both plans or requires that benefits be reduced for the existing plan. This double payment will be particularly disadvantageous to women, since they earn less and have less with which to make the payments. The benefit cuts will affect women disproportionately as well, since they are more dependent on Social Security benefits than are men and since more women than men are in or near poverty even with the current benefit levels. A mandatory "carve out" plan that uses a portion of the payroll tax to create a parallel structure of private individual savings accounts alongside the current insurance-based system is expensive and unnecessarily complicates the Social Security system.

The President's Proposal

The Universal Savings Accounts proposed by the President have the advantage of not requiring that Social Security funds be diverted to private accounts. Rather the new accounts are to be entirely voluntary, funded by individuals' savings and matched by tax credits (funded by the budget surplus) using a progressive formula (lower income savers get larger matches). Because of the matching funds, many individuals will prefer to save in these new vehicles than in the many existing alternatives. These individual savings accounts still raise several issues that need to be addressed:

- the administrative costs of having many small individual accounts may be high;
- the ownership of the accounts for married and divorced couples must be addressed;
- the future funding of the credits, when the budget does not have a surplus, is a serious fiscal issue.

The President also proposes to transfer the bulk of the surplus to the Social Security Trust Fund and to allow a small portion of it to be invested in equities. These two strategies ensure the solvency of the system for an additional 20 years, to 2055 approximately.

Both insurance-based systems like our current Social Security system and savings-based systems are valid forms of facing risk and financing retirement. Most families use both insurance and savings to protect against risks and provide for "rainy days." The President's proposal seeks to strengthen both types of protection.

How to Reform Social Security to Better Meet Women's Needs

Despite the many protections in Social Security that meet women's needs, there are still ways in which the system's rules, which are gender-neutral on their face, disadvantage women:

- using 35 years of earnings to calculate benefits, when far fewer women than men have that many years of paid work—proposals to increase the number of years of earnings used will disadvantage women further;
- not providing earnings credits for years taken away from paid work to provide family care;
- inequities between one- and two-earner couples such that, for couples with the same total pre-retirement income, those who shared the responsibility for earning more equitably have lower retirement benefits from Social Security than more traditional families in which the husband worked for pay substantially more than the wife;

• a drop of between 33 percent and 50 percent in the surviving spouse's Social Security benefits relative to the couple's benefits when both were alive, even though research shows the surviving spouse needs all but 20 percent of the couple's previous income to maintain the same standard of living; the surviving spouse is most typically a woman and the drop in benefits is largest when she worked enough to contribute substantially to the family income.

• the application of the "earnings test" (which requires benefit reductions when retirees earn more than the allowed amount) indiscriminately, regardless of how much prior work history the retiree has; some women who began work late may wish to keep working as long as they can to increase their future Social Security benefits (the President proposes to eliminate the earnings test entirely);

• the application of the "pension offset" rule indiscriminately, regardless of the size of the government pension and Social Security payments received; many female retired civil servants have small government pensions and small Social Security payments, yet Social Security payments are reduced accordingly. This gender-neutral rule affects women more adversely than men because women's benefits are likely to be much smaller because of life-time low earnings; the loss of even these small benefits hurts them disproportionately. Also private pensions are not required to be offset against Social Security; men are more likely to hold private pensions than are women.

Few reform proposals on the table address any of these issues that affect the size of the benefits women receive. Improving women's benefits is critical to reducing poverty among elderly women. Women over 65 are nearly twice as likely to be poor as men over 65 (13 percent vs. 7 percent), even though without Social Security women's poverty rate would be exceptionally high, 52 percent. Older unmarried women are even poorer, with a poverty rate of 22 percent. Social Security has worked well for women, but it could work even better.

Please find attached a Research-in-Brief published by the Institute for Women's Policy Research on the Impact of Social Security Reform on Women. The fact sheet summarizes the findings of a larger Institute report addressing several of the reform proposals on women. I have also attached a statement on Social Security developed by the National Council of Women's Organizations to present their views on the principles that any reform plan must meet. I hope that these three pieces convey to you the importance of Social Security for women, and that you take away the crucial point that any reform made to the system must improve the overall well-being of elderly women.

Statement of Hon. Carolyn B. Maloney, a Representative in Congress from the State of New York

Mr. Chairman. Thank you for recognizing the importance of the impact of Social Security on women by having this hearing today.

Lately we have been hearing a lot about ways to reform Social Security. However, the talk of Social Security benefits has largely focused on reform as if all people were the same. This is simply not the case. Women have different needs than men when it comes to Social Security.

Social Security is the mainstay of retirement income for women, with the average older woman relying on Social Security for 72 percent of their income, compared with 66 percent for men. One out of four women relies on Social Security for all of her income.

According to the Social Security Administration, in 1997, median income for elderly unmarried women (widowed, divorced, separated, and never married) was $11,161, compared with $14,769 for elderly unmarried men and $29,278 for elderly married couples. Thus, the poverty rate for elderly women was higher than that of men. In 1997, the poverty rate of elderly women was 13.1 percent, compared to 7 percent among men. Among unmarried elderly women, the poverty rate was significantly higher—about 19 percent.

There are many reasons why women are more dependent on Social Security. The main reason is that women, on average, live seven years longer than men. But, there are other reasons as well.

Women are less likely to have a pension. Only 38 percent of all women receive employer-provided pension benefits compared with 57 percent of men. One reason for this is that women tend to work for smaller companies which offer less generous pension plans—if they offer pension plans at all.

Women also usually earn less than men. Women ages 35 to 44 earn roughly 72 cents for every dollar earned by men. Younger women are narrowing that gap somewhat and now earn an average of 84 cents for every dollar. Nonetheless, lower salaries mean smaller Social Security payouts and thinner pensions.

Women often are the ones that spend time away from the workplace to raise a family or care for elderly parents. This not only diminishes the number of working years that pay into a retirement plan, but it also causes these women to lose seniority and experience that leads to promotions and raises. Social Security payouts are calculated by averaging the top thirty earning years of a person's life. If someone takes off time from the workforce and does not work thirty years, then zeroes are added in for those years.

The average age for a woman to be widowed in the United States is 55, and a recent report by the General Accounting Office shows that about 80% of widows now living in poverty were not poor before their husbands died. While men typically can count on two incomes throughout their lives, 80 to 90% of women will be solely responsible for their finances at some point in their life, according to the National Center for Women and Retirement Research.

With the challenges that women face, we must continue to have safeguards in place such as the ones used in our current Social Security system. It is important that our Social Security system not only be solvent for our children and our children's children, but it is also important that it gives our elderly the retirement security that they have earned. The effect on women should be one of the main focuses of any measure to change Social Security in order to make it more solvent.

As the incoming co-chair of the Congressional Caucus for Women's Issues, I intend to make sure that women's priorities are front and center as we continue to debate Social Security reform.

Statement of Diana Zuckerman, Ph.D., National Association of Commissions for Women, Silver Spring, Maryland

Women depend on the Social Security system, and that program has been a lifesaving safety net for many women, especially widows. We all agree that any changes made to Social Security need to consider how it will affect all our nation's citizens. The proposals that are being debated vary a great deal in their likely impact on women. As Director of the Social Security Project of the National Association of Commissions for Women, I welcome the opportunity to provide this testimony. The goal of this new Social Security Project is to make sure that policy makers and the American public are aware of the likely benefits and risks that various proposals would mean for American women.

The National Association of Commissions for Women is a non-profit, non-partisan membership organization composed of regional, state, county, and local commissions created by government, to improve the status of women. NACW works with legislators, commissions, women leaders, and corporate executives on a wide range of issues that are important to women. We are committed to safeguarding Social Security because it is a major source of economic security for millions of women all over the country.

Social Security benefits treat women and men the same way, but many provisions tend to benefit women more than men, or vice versa. For example, any married individual has a choice of whether to receive benefits based on their own lifetime earnings or half their retired spouses' benefits, but choosing half the spouses' benefit helps more women than men, since men earn more.

Social Security is more than a retirement program—it is a social insurance program that keeps millions of Americans out of poverty. That social insurance is essential for women. Although their Social Security benefits tend to be lower, women depend on Social Security more than men because women are much less likely to receive employer-provided benefits. Even when women receive private pensions they average only half the dollars received by men. Unfortunately, many of the proposals that are being seriously considered would put the lowest earners at greatest risk, and many of those lowest earners are women.

Proposals to privatize Social Security vary, but the basic plan is that most of the money that is currently set aside from each individual's paycheck for Social Security would instead go into an account for that individual, and the funds would be invested in stocks, bonds, or other private investments. Funds to pay for a safety net for society's most vulnerable, and the enormous costs of transitioning from the current "pay as you go" system to private accounts, would either result in higher taxes or cuts in some Social Security benefits. These proposed cuts would have very different impacts on women and men.

• Raising the retirement age would affect more women than men, since women live longer. In addition, women tend to marry men who are older than they are, and many women retire when their husbands stop working, in order to spend time with or take care of them. Under current law, the retirement age will gradually increase from 65, stopping at 67 for those born in 1960 or later. Several proposals would raise the retirement age to 67 even sooner, and would continue to increase it to age 70. Reduced benefits for early retirement would also be delayed.

• Calculating benefits on 38 years of employment rather than 35 years would decrease benefits for everyone, but women who spent several years out of the work force as "stay at home mothers" or to care for aging parents would be harmed more. The Social Security Administration estimates that only 30% of women who are retired in 2021 will have worked 38 years, compared to 60% of men. And, more of those women's years will be based on part-time salaries, because even today less than half of women between 25–44 years old are employed full-time.

• Raising the "cap" so that high earners pay taxes on more of their earnings would harm men more than women. This past year, workers and their employers paid Social Security taxes on the first $68,400 of an annual salary; since few women earn more than that, substantially raising the cap would have little impact on women.

• Lifetime benefits tend to benefit women more than men since women live an average of 7 years longer than men. Private accounts might run out of money while some long-lived individuals are still alive. If the individual buys private annuities in the insurance market, women will probably receive smaller payments because of their greater life expectancy. Moreover, the payments would not be indexed for inflation, which is more of a problem for those who live the longest.

• Lowering the annual cost of living index would have little impact for the first few years, but the cumulative impact over many years would mean substantial benefit cuts for retirees who live the longest. The longest living retirees tend to be women, and since women are more likely to live alone than men, these cuts will create more of a hardship for them.

• Many proposals would reduce guaranteed benefits that provide a safety net for our lowest earners. The lowest earners tend to be women, so they would be hurt more if the safety net was reduced. This could be a particular problem for divorced women, and the number of divorced retirees is skyrocketing because divorce is much more common than it used to be.

• Many proposals would reduce benefits for the disabled. Disabled workers and disabled children and adults who never worked are eligible for benefits; relatives who care for the disabled are usually women.

The National Association of Commissions for Women urges Congress to carefully consider how these changes would harm our nation's elderly women, many of whom are already living in poverty or near poverty. One strategy would be to tinker with the changes so that they would harm fewer women or harm women less—for example, by averaging fewer years of earnings for women who spend some years as full-time mothers. However, tinkering with the changes to make them less harmful to women would also result in less savings to the Social Security system, and other changes would therefore be needed to provide greater savings. For that reason, preserving the Social Security safety net and using money from the budget surplus to help save Social Security is a strategy that helps protect women. Any plans that focus primarily on increasing the rate of return on a proportion of earnings or on money set aside in voluntary savings will benefit low earners less—and that means women will benefit less.

Members of the National Association of Commissions for Women will be speaking up on this issue all over the country, and will be contacting their representatives in Congress in the weeks and months ahead. Commissioners appreciate your interest in Social Security as a program of particular importance to women, and will keep you informed of the concerns of women in your districts and communities. Our president, Patricia Hendel, looks forward to working with all of you as various proposals are considered. As Director of the Social Security Project, I also welcome the opportunity to work with you and will be available to provide you with information about our efforts, our concerns, and our analyses of how specific proposals would affect women in your district.

Statement of National Association of Manufacturers

The National Association of Manufacturers (NAM) is the largest broad-based trade association in the nation. Founded over a 100 years ago, the NAM encompasses nearly 14,000 member companies that account for 85 percent of goods manufactured in the United States. NAM members range in size from companies with fewer than 25 employees to those with more than 100,000.

Social Security is a top domestic priority for the NAM. Our 1999 legislative agenda notes that "the current system is demographically unsustainable and gives workers low or negative returns on their contributions; and that individually owned and controlled personal retirement accounts would provide workers with larger more secure benefits than today's system." Failure to adequately remodel Social Security would threaten the economic and retirement security of working men and women, and American business. Absent reform, the unfunded obligations of the government will tax the growth out of the economy, tax jobs out of the economy and make it extremely difficult for U.S. employers to compete in world markets.

Given this legislative priority, the NAM has taken a leadership role within the business community in addressing solutions to fix this 64-year old retirement program. To this end, the NAM Board of Directors approved reform principles in April 1997. We have testified numerous times before Congress; convened bipartisan grassroots forums across the country; and, last summer, established a lobbying coalition, the Alliance for Worker Retirement Security (AWRS).

AWRS includes various business trade associations, corporate members and representation from other concerned groups, including women and minorities. Like the NAM, AWRS is dedicated to reforming the Social Security system to ensure an adequate retirement income and an opportunity for workers to create personal economic wealth. Both the NAM and AWRS believe Social Security reform must respect the following principles:

- Permit workers to invest their retirement payroll taxes (FICA) in individually directed personal retirement accounts (PRAs).
- Preserve the benefits of current retirees and near-retirees.
- Guarantee a "safety net" (minimum government benefit) for all retirees.
- Accomplish the above with no increase in payroll taxes.

The NAM recognizes that all workers do not have the same personal and family needs and encourages its members to tailor benefit packages and work schedules to respond to these differences. In the same way, a refashioned Social Security system must recognize the different work and family patterns of today's women versus the model on which the 1935 program was based.

Women and Retirement Security

A visit to Miami Beach, Fl., Sun City, Ariz., and most other retirement communities reveals a largely female retiree population. Roughly 60 percent of Social Security recipients today are women and more than 95 percent of women age 65 or older receive benefits. Thus, any discussion of Social Security reform must closely examine the needs of elderly women, in the process of redesigning the system.

Certain inequities present in the system treat women unfairly. Because few women worked outside the home in the 1930s, women would have received very meager benefits. To remedy this, in 1939, "spousal benefits" were added as a protection for widowed housewives. This created a system in which a one-earner couple receives greater benefits than a two-earner couple with the same income. A spouse is automatically entitled to a benefit equal to half of her spouse's benefit, whether or not she has worked. If she has worked, she is entitled to her own benefit or to the spousal benefit, but not both.

A woman typically earns less and works fewer years than her husband, so her benefit is often less than half of his. In such a case, a woman would be better off with the spousal benefit because it would be larger. She could, however, receive this benefit without working, so in a sense she gets no credit for her own work or her taxes.

The above inequities should be addressed. Even in so doing, the resulting changes would still yield a relatively small benefit on which to live out one's retirement years, which for women are at least four years longer than men. Further, Social Security's unfunded status means that by 2032, the Trust Fund will only be able to pay 75 percent of promised benefits or some $200 less in each monthly beneficiary check. This is especially critical since women beneficiaries average $621 per month versus an average of $810 for a male. Clearly, a reformed system must be restructured to provide an adequate retirement income to both men and women.

PERSONAL RETIREMENT ACCOUNTS: A BETTER WAY

As noted above, the NAM supports retaining a safety net of benefits for all retirees. A safety net assures a basic level of benefits. At present, not all retirees receive even a poverty-level benefit, due to a reduced work history. We need to do more, however, to supplement even an enhanced safety net. Personal Retirement Accounts offer that opportunity.

A bipartisan plan introduced in the 105th Congress would have taken 2 percent of each worker's FICA tax and placed it in a personal retirement account (PRA), administered in a manner similar to the federal employees' thrift savings plan (TSP). Individuals would choose from among a number of potential investments, such as stock funds, bond funds, a combination or even U.S. Treasury securities. PRAs would be the property of individuals and eventually pass to survivors or heirs, unlike Social Security benefits that cease with the beneficiary's death.

Rules would have some similarity to those for 401(k) plans, but with major exceptions. Use of PRAs as collateral for loans or for medical or educational purposes would be prohibited, since PRAs must be reserved for retirement only. Less frequent benefit statements and fewer opportunities to change allocations are anticipated as a way to keep down system costs, at least initially. Because investing will take place over the long term, risk is minimized.

Upon retirement, a female retiree would receive a basic defined benefit (similar to what is received from Social Security today). In addition, a female retiree would also receive her PRA with interest compounded over 30–40 years. Payout would be in the form of an annuity. This could be adjusted depending on other existing retirement income.

PRAs have many advantages. Individual accounts would permit women to grow their money, unlike Social Security that returns a mere 1.5 percent to 2 percent on average. Money invested privately in the market, over a long period of time, poses minimal risk—a conclusion reached by many economists, from liberal to conservative. Remaining assets would be passed on to survivors and heirs. You cannot do this with Social Security.

Critics of PRAs point to the fact that the average American does not have the expertise to invest wisely. Women are perceived as especially ill-prepared to make investment decisions. Yet female participation in 401(k) plans is higher than that of similarly situated men, according to a 1998 study released by Watson Wyatt. The study reviewed 150,000 employees in 87 401(k) plans. This same study revealed that women also set aside a greater portion of their pay than their male colleagues, except among younger and less well-paid workers. Restructuring Social Security should provide all women with opportunities now enjoyed by the higher-paid. PRAs would help all women to build a nest egg for retirement.

The argument that low-income women, in particular, should not jeopardize any portion of their Social Security defined benefit because the private market is too risky, fails to consider that the current system is slated to run in the red. By investing a portion of the FICA tax in carefully selected stock or bond funds over the long term, a female retiree stands a far better chance of enhancing her retirement resources. This two-tiered approach permits her money to grow, even while she may be temporarily out of the workforce raising children or for other purposes.

CONCLUSION

The current Social Security system, based on a 1930s' model, is inadequate in responding to the needs of women retirees who live longer and earn less wages or salary than do men. Further, current law shortchanges women who work. Taken together, these factors demand reforms to the defined benefit portion of Social Security and the creation of new opportunities for women to accumulate additional sources of retirement income.

A revamped system featuring individually directed PRAs as an integral part of Social Security is a sensible, workable approach that will help workers—particularly women. At the same time, a strengthened Social Security system will help keep the economy strong and contribute to a brighter future for all Americans. The NAM believes that this approach is far superior to having the federal government invest the Trust Funds in the private market. We urge Congress to work together in a bipartisan manner to enact legislation to this end, and we pledge to work with you toward this important goal.

REDUCING POVERTY AND PROTECTING MINORITIES, SURVIVING FAMILIES, AND INDIVIDUALS WITH DISABILITIES

WEDNESDAY, FEBRUARY 10, 1999

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SOCIAL SECURITY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 1:32 p.m., in room B–318, Rayburn House Office Building, Hon. E. Clay Shaw, Jr. (Chairman of the Subcommittee), presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE CONTACT: (202) 225–9263
February 3, 1999
No. SS–3

Shaw Announces Third Hearing Day in the Series on Impacts of the Current Social Security System

Congressman E. Clay Shaw, Jr., (R–FL), Chairman, Subcommittee on Social Security of the Committee on Ways and Means, today announced that the Subcommittee will hold a third day in a hearing series on Social Security's role in reducing poverty and protecting minorities, surviving families, and individuals with disabilities. The hearing which began on Tuesday, February 2, 1999, will be continued on Wednesday, February 10, 1999, in room B–318 Rayburn House Office Building, beginning at 1:30 p.m.

Oral testimony at this hearing will be from invited witnesses only. Witnesses will include Social Security program experts and representatives of interested groups. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

Our nation's Social Security program was enacted in 1935 to help reduce poverty among the elderly. Poverty rates among the elderly fell from 35.2 percent in 1959 to only 10.5 percent in 1997—a 235 percent reduction just since reliable poverty statistics began being kept. Further, today's senior poverty rate is among the lowest for all age groups on the basis of income, and when the value of housing is considered, seniors have the lowest poverty rate of any age group at only 5.6 percent. In addition, numerous inflation adjustments, benefit expansions, and tax base increases have contributed to enhanced protections for low-income workers, including many minorities. The total number of persons removed from poverty in 1996 due to social insurance programs (chiefly Social Security) was almost 18 million—or 1 in 15 Americans.

Many Americans think of Social Security as a retirement program, but program expansions after 1935 extended Social Security's protections to surviving widows and children (in 1939) and individuals with disabilities (in 1950 and 1956). Today, nearly one-third of beneficiaries are the survivors of workers who died prematurely or people with disabilities and their families. For 4.5 million beneficiaries and their families, Social Security disability benefits not only help to replace income lost due to the inability to work; eligibility for this program also provides a gateway to other services and benefits, including Medicare and vocational rehabilitation.

In announcing the hearing, Chairman Shaw stated: "Social Security is the number one weapon in our Nation's arsenal against poverty, having successfully freed millions of seniors and families threatened with financial insecurity due to death, disability, or retirement from the clutches of poverty. Members and the public need to better understand how Social Security has achieved this record of success, and how Social Security can be strengthened as reforms are considered to protect our Social Security safety net for generations to come."

FOCUS OF THE HEARING:

The third hearing day in a series on the impacts of the Social Security program will focus on how Social Security protects workers and families against risks such as disability, death, and retirement. The hearing also will focus on how Social Security affects minority families, who face disproportionate risk of low income, disability, and premature worker death.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the close of business, Wednesday, February 24, 1999, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Social Security office, room B–316 Rayburn House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman SHAW. Good afternoon.

Social Security is an important weapon in the Nation's arsenal against poverty. In fact, Social Security played a key role in lifting almost 18,000,000 Americans out of poverty in 1996, more than the population of Los Angeles and Chicago combined. That's one in 15 Americans.

This success is possible because of Social Security's role as an insurance program. We pay a portion of hard-earned wages into the system to ensure us against loss of income due to disability, retirement, or death. For example, some workers may qualify for more years of disability benefits than they spent in the work force. These benefits are critical to maintaining a certain standard of living for disabled persons who can no longer work.

The Social Security contract between workers and government has survived for 60 years because Americans are confident that Social Security will be there for them when they need it.

However, that confidence is eroding for one simple reason: Demographics. The bottom line is that unless Social Security is reformed soon, revenues will no longer cover benefits after the year 2012.

By the year 2032, benefits will have to be cut by 25 percent unless payroll taxes are increased by 50 percent to make up the difference. It is a critical fact that those most at risk are the same low-income minority and disabled workers and families who most depend on Social Security benefits today.

None of these families can afford a 25-percent benefit cut. None should have to do so. For them and everyone else, Social Security already provides too few choices, no real savings, and too many hurdles to work and independence.

The status quo will make these matters worse, adding insult to injury already felt when millions of American families are deprived of income due to worker disability, retirement, or death.

So I look forward to our testimony today, which will highlight that doing nothing is not acceptable; especially for our low-income, minority, and disabled workers and their families. That is our starting point. Where we end, I will not judge. But I will continue to keep my ears and mind open to the best ideas to preserve and improve Social Security's prospects for current families and generations to come.

I know Mr. Matsui is also very concerned about this area. In fact, I saw a very nice article about him in his local paper, which I have just read this morning, in which you do talk about disability and your concern about that.

So, I would now recognize the gentleman from California.

Mr. MATSUI. I thank the gentleman from Florida and the Chairman of the Subcommittee.

First of all, I'd like to thank you for your very kind comments in that article. I appreciate the spirit of bipartisanship.

I might also want to thank Mr. Shaw for the fact that this is the second hearing on a number of very crucial issues. One was on the issue of women; and this one is on the issue of protecting survivors and disability benefits, and minority and low-income families, and how all of these groups have been affected by Social Security.

And I just want to thank you, Clay, for having separate Subcommittee hearings on each of these areas. It's very much appreciated.

I would just like to reiterate what the Chairman has said. Obviously, the Social Security basic benefits are crucial to almost every American, but equally as important are the survivors and disability benefits. As all of us know, survivors and disability benefits, if they were in the form of insurance policies, would average on the range of $300,000 per family. And so these benefits are for those that become disabled or if they have a loss of the breadwinner in the family, basically another safety net before the age of 65.

And so, this, along with other issues that will be discussed by GAO and other witnesses today are very, very important to the whole issue of how we structure Social Security and what we do in terms of the long-term future of the system.

And so, again, I want to thank Mr. Shaw and thank the witnesses.

Chairman SHAW. Thank you. Our first witness is from the U.S. General Accounting Office. Cynthia Fagnoni is the Director of Income Security Issues in the Health, Education, and Human Services Division. And she is accompanied by Francis Mulvey, who is Assistant Director, Income Security Issues in the Health, Education, and Human Services Division. Welcome both of you. Your full statement will be made a part of the record, and you're free to summarize as you see fit.

STATEMENT OF CYNTHIA M. FAGNONI, DIRECTOR, INCOME SECURITY ISSUES, HEALTH, EDUCATION, AND HUMAN SERVICES DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY FRANCIS MULVEY, ASSISTANT DIRECTOR, INCOME SECURITY ISSUES, HEALTH, EDUCATION, AND HUMAN SERVICES DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Ms. FAGNONI. Thank you. Good afternoon, Mr. Chairman and Members of the Subcommittee.

Thank you for inviting me here today to speak about the implications of Social Security reform for minorities. In my statement today, I will focus on three issues: How minorities fare under the current Social Security system; how they might be affected by some proposed changes in benefits to restore program solvency; and how minorities might fare under a restructured system to include individual accounts.

My remarks will focus on two minority groups—African-Americans and Hispanics—because the data we are analyzing do not provide sufficient information on other populations, such as Asian-Americans or Native Americans.

The information I am presenting today is based upon work we have currently underway for Representative Charles Rangel, Ranking Minority Member of the Full Committee.

Regarding the first issue, how minorities fare under Social Security, it is important to note that the Social Security system is gender-, ethnicity-, and race-neutral. However, blacks and Hispanics are more likely to have certain characteristics that affect the level and extent of benefits they receive relative to the contribution they make.

Blacks, for example, have shorter life expectancies than Hispanics or whites, and thus are more likely to receive retirement benefits for fewer years. But life expectancy is only one of many factors that affect benefit levels.

Social Security's progressive benefit formula has particular importance for both blacks and Hispanics because they tend to have lower lifetime taxable earnings than whites.

In addition, blacks rely more heavily on Social Security's disability and survivors benefits, which provide important protections against the loss of earnings caused by death or disability.

For example, while blacks currently make up 12 percent of the U.S. population, they make up 18 percent of disabled workers, and 23 percent of child beneficiaries.

Regarding the second issue, how Social Security benefit reductions would affect minorities, we found that minorities would be disproportionately affected by certain reforms. Many proposals would increase the age at which individuals can begin receiving Social Security retirement benefits. Because blacks, on average, can already expect to spend fewer years in retirement than whites, they would experience a greater relative reduction in benefits.

On the other hand, Hispanics have, on average, longer life expectancies. For them, the negative effect of raising the retirement age would be smaller in relative terms. An across the board benefit cut, such as increasing the number of years of earnings used in calculating Social Security benefits could have a more serious effect on blacks and Hispanics, because their lower overall incomes put them much closer to or below the poverty line to begin with.

At the same time, an increase in the retirement age would have implications for the Disability Insurance Program. Raising the early and normal retirement ages would create a financial incentive for individuals in poor health to apply for DI benefits, because the gap between disability and retired worker benefits would increase.

Also, as individuals stay longer in the work force, more older workers are likely to become disabled.

Assuming the disability trends continue, proportionately more of these disabled workers would be black.

Now, let me discuss the third issue: How minorities might fare under a restructured Social Security system. Many proposals would create individual retirement accounts that individuals would own and manage in addition to providing some level of benefits based on years of covered earnings.

Because research has not previously been done on minorities' investment patterns, we have estimated the effect of race on individual investment behavior. Our preliminary results indicate that education and family income are better predictors of individuals' investment behavior than race.

Specifically, individuals with less education and lower incomes tend to investment more conservatively than individuals with more education and higher incomes; and, on average, blacks and Hispanics have lower family incomes and fewer years of education than whites.

Individuals who chose a relatively low-risk investment strategy for their retirement income accounts would be likely to earn lower rates of return over longer periods of time, but they would not be as exposed to large losses from riskier assets. And while it is true that, in the past, U.S. stocks have almost always posted higher returns over time than less risky assets, there is no guarantee that they will always do so, especially for shorter investment horizons.

Our analysis also revealed that blacks and Hispanics are much less likely to have interest earnings from any other type of savings vehicles, such as savings accounts, money market funds, certificates of deposit or mutual fund accounts. Individuals unfamiliar with making investment choices may need assistance in understanding and managing their individual account investments. Providing low-income and less well-educated individuals who have limited investment experience with appropriate information may be particularly challenging.

Nevertheless, information that covers general investment principles and financial planning advice would be essential in helping all investors to better manage their accounts.

It is not clear who would provide such information to workers under a restructured Social Security system that included mandatory individual accounts. The nature and extent of these information and education efforts, when combined with the design of related investment options, would be especially important in maximizing the effectiveness of and minimizing the risk associated with individual accounts.

Mr. Chairman, this completes my short statement this afternoon. I'd be happy to answer any questions you might have.

Thank you.

[The prepared statement follows:]

Statement of Cynthia M. Fagnoni, Director, Income Security Issues, Health, Education, and Human Services Division, U.S. General Accounting Office

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to speak about minorities and Social Security. Social Security has had a significant and positive effect on the nation's elderly. Since 1959, poverty rates for the elderly have fallen from 35 percent to 10.5 percent, thanks largely to this social insurance program. Nevertheless, elderly African-Americans and Hispanics are much more likely to be living below the poverty line, even with the program's important benefits. For example, 28 percent of African-Americans and 27 percent of Hispanics aged 65 and older have incomes below the poverty threshold, compared with 11 percent of similarly aged Caucasians.[1]

My remarks today focus on (1) how minorities currently fare under Social Security, (2) how they might be affected by some of the proposed changes in benefits to restore the program's solvency, and (3) how minorities might fare under a system restructured to include individual accounts. The information I am providing today is based on preliminary findings from work we are currently doing for Representative Charles B. Rangel, Ranking Minority Member of the full Committee on Ways and Means.

In summary, while Social Security's benefit and contribution provisions are neutral with respect to race, ethnicity, and gender, we found that because of certain socioeconomic characteristics, minorities have benefited from the Social Security program. Because minorities are more likely than whites to have lower lifetime earnings, they are advantaged by Social Security's progressive benefit formula that provides larger relative benefits for lower-paid workers. Moreover, blacks in particular are more likely to receive other important Social Security benefits, such as disability, that help protect against lost earnings. Certain reforms that would reduce benefits to help restore solvency could have a disproportionate effect on low-wage earners, including blacks and Hispanics, depending on how they are structured. For

[1] Most of the data sources we relied on used the terms blacks, whites, and Hispanics. Therefore, for the remainder of this testimony we use the same terms. Although we recognize that there are other minority groups, such as Asians and Native Americans, for the most part the data were not broken down finely enough for us to look at them separately.

example, raising the age of retirement would lower the average lifetime benefits of blacks relative to whites because of blacks' lower life expectancy.

Restructuring Social Security to include individual accounts would also likely have varying effects on different racial and ethnic groups. However, our analysis indicates that education and family income are better predictors of individuals' investment behavior than race. Individuals with less education and lower incomes tend to invest more conservatively than those with more education and higher incomes. Because blacks and Hispanics are more likely to have less education and lower incomes, they would likely earn smaller returns on their accounts, although they would bear less risk. These results suggest that if individual accounts were adopted as an element of comprehensive Social Security reform, investor information and education would be needed to help low-income individuals with their investment decisions.

BACKGROUND

The Social Security program is the foundation of the nation's retirement income system. Since 1940, Social Security has been providing benefits to the nation's eligible retired workers and their dependents. In addition to retired worker benefits, Social Security protects covered workers who have severe disabilities and their dependents through the Disability Insurance (DI) program. Also, spouses and children of deceased workers may receive Social Security survivor benefits. As a social insurance program, Social Security allows workers to pool the risks they face from a loss of earnings that results from retirement, disability, or death.

Social Security's benefit formula redistributes income from high-wage earners to low-wage earners to help keep low-wage earners out of poverty. Benefits are based, in part, on an individual's earnings, but when calculating actual benefits, Social Security uses a progressive formula that replaces a relatively larger portion of lifetime earnings for people with low earnings than for people with high earnings. To calculate Social Security benefits, Social Security uses average indexed monthly earnings, defined as a worker's lifetime covered earnings over his or her 35 highest earnings years. A progressive benefit formula is applied to these lifetime earnings to determine the benefit that would be payable to the worker at age 65. The benefit is then adjusted for the age at which the worker first receives the benefit.

The Social Security system currently faces a long-term solvency problem. As you know, the Social Security trust funds are predicted to begin paying out more in annual benefits than they collect in taxes in 2013 and are expected to be depleted by 2032.[2] A number of proposals have emerged to resolve this financing problem, with a great deal of variety in terms of both how the Social Security program would be structured and who would be eligible for benefits.[3] Some of these proposals would restore solvency within the existing program structure, while others call for some form of restructuring to include individual accounts as an element of reform. Many major proposals would provide a significant defined benefit as a base with voluntary or mandatory individual accounts included as an element of the plan.[4] In the current national debate over how best to restore Social Security's long-term solvency, some researchers have argued that minorities, particularly blacks, would fare better under a system that included some individual account element.[5] They argue that certain minorities are more likely to have specific characteristics that result in their receiving lower benefits than others under the current system.

HOW MINORITIES CURRENTLY FARE UNDER SOCIAL SECURITY

Although Social Security's benefit and contribution provisions are neutral with respect to race, ethnicity, and gender, some researchers have questioned how well some minorities, especially blacks, have fared under the existing Social Security system because they have lower life expectancies. Differences in life expectancy affect the length of time that individuals from different racial and ethnic groups can expect to pay into the Social Security system and collect retired worker benefits. For example, white males born in 1998 can expect to live for 74 years, black males for

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[2] The relevant figures include both the Old Age and Survivors Insurance program and the Disability Insurance program.

[3] The President's recent Social Security reform proposal, for example, would extend Social Security solvency until 2055. It would not, however, fundamentally reform the Social Security benefit program.

[4] Defined benefit refers to a benefit based on a specific formula linked to a worker's earnings and years worked.

[5] W. Beach and G. Davis, "Social Security's Rate of Return," Heritage Center for Data Analysis, Heritage Foundation, Washington, D.C., 1998.

64.3 years, and Hispanic males for 75 years. These differences become much less pronounced, but still exist, for individuals who survive to age 65. At age 65, in 1998, white men can expect to live 2.3 years longer than black men, and Hispanic men can expect to live 2.9 years longer than white men. The projections of life expectancy for white, black, and Hispanic women at age 65 are 19.5, 17.6, and 22.2 years, respectively.

However, life expectancy is only one of many factors that affect the level of benefits that people receive from Social Security, relative to what they contribute. Social Security's progressive benefit formula has particular importance for blacks and Hispanics because they tend to have lower lifetime taxable earnings than whites. The consensus among researchers is generally that the progressivity of the benefit formula outweighs the negative effect of lower life expectancy for blacks in terms of what they receive from Social Security relative to what they contribute. Hispanics' longer life expectancy, combined with the progressive benefit formula, indicates that they fare even better than blacks under Social Security.

None of the currently available studies have included disability or survivors benefits in their assessments of the benefits minorities receive from Social Security.[6] Blacks rely more heavily than others on these features of the program, which provide important protections against the loss of earnings caused by disability or death. While blacks currently make up 12 percent of the U.S. population, they are overrepresented in these beneficiary categories. For example, blacks make up 23 percent of child beneficiaries (as children of retired workers, disabled workers, or deceased workers), 18 percent of disabled workers, and 14 percent of survivors of deceased workers. Put another way, 47 percent of black beneficiaries are receiving either disabled or survivor benefits, while only 28 percent of whites are receiving benefits in these categories. In contrast, blacks make up only 8 percent of all retired worker beneficiaries, while whites make up 90 percent of this category.[7]

HOW MINORITIES MIGHT BE AFFECTED BY VARIOUS REFORM PROPOSALS WITHIN THE EXISTING PROGRAM STRUCTURE

The changes contained in various Social Security reform proposals could have disproportionate effects on minorities but these would vary depending on the nature of the reforms. Many reform proposals include provisions that would reduce current benefit levels by, for example, increasing the number of years of taxable earnings used to calculate benefits from 35 years to 38 or 40 years. Even a proportional reduction in benefits such as this could have a more serious effect on minorities since their lower overall incomes put them much closer to or below the poverty line to begin with.

Many Social Security reform proposals include a provision to raise the normal age of retirement to age 70. Some proposals would also increase the early retirement age from 62 to 65. Any increase in the age at retirement would decrease the number of years during which individuals would collect benefits while increasing the number of years they would pay Social Security taxes. Because blacks, on average, already can expect to spend fewer years in retirement than whites as a result of their shorter life expectancy, they would experience a greater relative reduction in benefits, compared with whites, from an increase in the Social Security retirement age. Given Hispanics' longer life expectancy, the negative effect of raising the retirement age would be smaller in relative terms. At the same time, an increase in the ages of early and normal retirement would have implications for the DI program. Raising the early and normal retirement ages would create a financial incentive for individuals in poor health to apply to the DI program because the gap between disability benefits and retired worker benefits would increase. Moreover, as individuals stay longer in the labor force, more older workers will become disabled. Assuming that current disability trends continue, proportionately more of these disabled workers would be black.

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[6] We are currently working with a special data set, provided by the Social Security Administration and the Bureau of the Census, that will allow us to make more complete estimates of minorities' total returns to Social Security, including disability and survivors benefits. This information will be forthcoming in a report to Representative Charles B. Rangel, Ranking Minority Member of the House Committee on Ways and Means, later this year.

[7] Hispanics were not reported separately and are included in the numbers for whites and blacks. The final 2 percent of retired worker beneficiaries includes Asians and Pacific Islanders, American Indians and Alaskan Natives, and a subset of the total number of beneficiaries of Spanish origin.

HOW MINORITIES MIGHT FARE UNDER A SYSTEM RESTRUCTURED TO INCLUDE INDIVIDUAL ACCOUNTS

Many reform proposals would fundamentally restructure Social Security by creating retirement accounts that individuals would own and manage. Many proposals would provide a defined benefit but would also include an individual account feature. For example, the plan put forth by the National Commission on Retirement Policy includes a minimum benefit provision that is set at the poverty line for individuals who have worked for 40 years and directs 2 percentage points of the payroll tax into individual savings accounts. Because no research has previously been done on minorities' investment patterns, we have estimated the effect of race on individual investment behavior. Using national survey data, we estimated the probability that people with Individual Retirement Accounts (IRA) would invest their accounts in stocks and mutual fund shares.[8] Our preliminary results indicate that individuals with higher family income and more years of education are more likely to invest in more volatile but potentially higher-yielding assets such as stocks and mutual funds. On average, blacks and Hispanics have lower family incomes and fewer years of education than do whites. We found that controlling for these and other characteristics, black IRA holders are still somewhat less likely to invest in stocks and mutual fund shares than whites.[9] We also found that Hispanic IRA holders are neither more nor less likely than whites to invest their accounts in stocks or mutual fund shares, once we controlled for the other demographic characteristics.

Individuals who chose a relatively low-risk investment strategy for their retirement income accounts would be likely to earn lower rates of return over longer periods of time but would not be as exposed to large losses from riskier assets. While it is true that in the past U.S. stocks have almost always posted higher returns over time than less risky assets, there is no guarantee that they will always do so, especially for shorter investment horizons.

Our analysis also revealed that blacks and Hispanics are much less likely to have interest earnings from any other type of savings vehicles such as savings accounts, money market funds, certificates of deposit, or mutual fund accounts. Individuals unfamiliar with making investment choices may need assistance in understanding and managing their individual account investments. Providing low-income and less well-educated individuals who have limited investing experience—including some blacks and Hispanics—with appropriate information may be particularly challenging. Nevertheless, information that covers general investment principles and financial planning advice would be essential in helping all investors to better manage their accounts. It is not clear who would provide such information to workers under a restructured Social Security system that included mandatory individual accounts. Within the private pension system, there are mechanisms for people to learn more about investing. For example, some employer-sponsored pension plans provide written material or contract with a financial planning service to give employees information about investing. It might be possible to draw from these experiences in structuring an investor education program for Social Security. The nature and extent of these information and education efforts, when combined with the design of related investment options, would be especially important to helping maximize the effectiveness of, and minimize the risk associated with, individual accounts under the Social Security system.

CONCLUSIONS

The Social Security system has benefited minorities through a benefit formula that favors lower-paid workers and through important social insurance features, including disability benefits. Because blacks and Hispanics are more likely to have lower overall incomes than whites, certain reforms, such as increasing years of covered earnings, would have a more serious effect on them, because they are already closer to the poverty line. Because blacks and Hispanics on average have lower incomes and are less well educated than whites, the creation of mandatory individual accounts could also decrease their benefits relative to those of whites if they in-

[8] We used a cross-section of people from Census' 1992–93 Survey of Income and Program Participation. Because of data limitations, we were able to look only at the investment decisions of people with IRAs. In the full sample, blacks and Hispanics were less likely to have an IRA account than whites. In general, respondents with IRAs had higher family income, had completed more years of education, were older, were more likely to be married, and had fewer children than those without IRAs.

[9] This result was significant at the 90-percent confidence level. The analysis did not control for differences in levels of wealth, which would also explain some of the differences in investment behavior.

vested more conservatively. Our work suggests that providing information and education would be essential, especially to low-income individuals who would be making investment decisions for the first time. Investor education that covers general investment principles and financial planning advice might help all new investors to better manage such accounts.

This concludes my prepared statement. I would be happy to answer any questions you or other Members of the Committee may have.

Chairman SHAW. Thank you.

Mr. Hulshof.

Mr. HULSHOF. Thanks, Mr. Chairman. I realize in the interest of time that you didn't get to your entire statement, Ms. Fagnoni. But one of your conclusions is that the present Social Security system, I'll just read your introductory sentence of conclusion, "The Social Security system has benefited minorities through a benefit formula that favors low-paid workers and through important social insurance features, including disability benefits."

Basically, I think what you're saying is through the progressive benefit formula and the availability of disability benefits that minorities have benefited from the present structure, is that true?

Ms. FAGNONI That's correct. Right.

Mr. HULSHOF. Now, also some of the proposals that have a defined benefit, but also include an individual account feature that you touched on briefly. Do these proposals, at least the ones you've looked at, do they eliminate this progressive benefit formula?

Ms. FAGNONI. Well, as I'm sure you know, there are a range of different proposals and proposal packages that are out there on the table. From the ones we've looked at, for example, a recent one by the Center for Strategic and International Studies would reduce the progressivity of the benefit formula, but not completely eliminate it. And many of the proposals would leave, from what we can tell, would leave the disability insurance component intact.

Mr. HULSHOF. Let's just talk some basics. And I recognize that we have to talk in generalities. For instance, some of the themes you touched on, we talked about in previous hearing. For instance, some of the inequities in the system as it relates to women. And one of the things was that we had in a previous hearing the Chairman called was the more conservative investment patterns, and, again in general terms because as I pointed out at that hearing, in the Hulshof household that's not the case as far as who's the more conservative investor. But let's say that a single black male, an African-American male works in an average paying job, and then dies at age 60. I think, first, we need to start off with by explaining what happens with the money that he or she has paid into the Social Security system under that scenario?

Ms. FAGNONI. Well, first of all, we know from research that blacks are more likely to rely on disability insurance benefits, and so one of the things you'd want to look at is whether or not before that time of death at age 60 whether that individual might have been drawing from the Social Security Program, for example, through the DI Program. So there is the potential for them to receive benefits, even if they're single——

Mr. HULSHOF. Right.

Ms. FAGNONI [continuing]. Prior to getting retirement benefits. Clearly, if they have a spouse or children, there are significant benefits if they die before they reach retirement age.

Mr. HULSHOF. But take that out of the hypothetical. Let's just say a hard-working African-American male, who pays into the system until 60, and then dies under the present system, assuming there had been no tapping into the disability side, what would happen to the money that he's paid into the system?

Ms. FAGNONI. Well, this is part of a social insurance system where people make contributions, in part to protect themselves against risk, but also to provide for retirement should they reach retirement age, and that's part of the actuarial assumptions, factored in that an individual might not receive the retirement benefits should they die before the retirement age.

Mr. HULSHOF. And I don't mean to make this more than difficult than it is. The fact is that that hard-working African-American male, who dies at age 60, would not see any benefits of what he has paid into the system over the course of his lifetime.

Ms. FAGNONI. That's right. If they had not—right.

Mr. HULSHOF. Would that then change if individual accounts were part of the system. The same African-American male working in the average job, hard working all of his life, but individual accounts then became a personal accounts, and I don't know what we would call them, but were part of the system.

Are there some proposals, in fact, that would allow whatever assets or maybe that's not the correct word, because it's an accounting situation. But would that not, then, be able to be passed on to that individual's heirs? Is that part of the feature of some of the individual accounts?

Ms. FAGNONI. Well, you're correct that under certain scenarios somebody who has an individual account component would have assets remaining in their own name even if they die before they receive maybe the defined benefit portion of the retirement benefits. What that package—what that individual account looks like would, of course, depend on what that individual's earnings were and what he chose to put into the account, and how he chose to invest it.

Mr. HULSHOF. Mr. Chairman, recognizing we have a lot of other good witnesses, I'll yield back the balance of the time that I have remaining.

Chairman SHAW. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman. Ms. Fagnoni, thank you for your report. This is the preliminary report, as it might have been?

Ms. FAGNONI. Yes, we still have analysis we're doing.

Mr. MATSUI. Right. When do you suppose that you might have this completed?

Mr. MULVEY. We are hoping to have this completed some time in the early summer.

Mr. MATSUI. OK. That's good. One of the things I've noted in here is on page three, you talk about disability and survivors benefits, and speaking about African-Americans specifically, you state that while blacks currently make up 12 percent of the U.S. population, there are over represented in both the survivors category and also the disability category. In fact, 23 percent of child beneficiaries are from African-American families. Do I have that right?

Ms. FAGNONI. Right.

Mr. MATSUI. Right. OK, that's probably a more positive way of putting it in terms of a correct statement. African-Americans make up 18 percent of disabled workers and 14 percent of survivors of deceased workers, and then you have put another way: "47 percent of black beneficiaries are receiving either disabled or survivors benefits, while only 28 percent of whites are receiving such benefits. In contrast, blacks make up only 8 percent of all retired worker beneficiaries" whereas whites make up 90 percent of that category.

One of the problems I have, and I guess your final report will have this is how you break this down in terms of benefits per capita, on an average basis, in these different categories that we're talking about. Will you have that?

Ms. FAGNONI. You mean in terms of what their benefits would look like?

Mr. MATSUI. Well, maybe it's too difficult to do this, but how do we come up with a value placed on, let's say per individual, per family in terms of a Social Security benefit. I think we were able to do that somewhat with women, because there's probably more information on women. But in terms of minority populations, there's, from my understanding, no statistics. Although just preliminarily looking at these numbers, it seems pretty obvious that an African-American family with the larger disabilities and survivors benefits probably benefits significantly more than, let's say, the general population. Is that a correct, fair statement?

Ms. FAGNONI. Right. The existing research generally shows that the progressive benefit formula outweighs the fact that blacks in particular have shorter life expectancies, and that they benefit relative to their contributions. But we are—the piece of our analysis that's not complete is looking at the total benefit package that different minority groups receive and comparing that against whites, including disability and survivors benefits, and looking at contributions compared with benefits. So that's the piece that will help enrich that current body of research.

Mr. MATSUI. Right. See, the mere fact that a category of individuals dies earlier than another category is not necessarily conclusive of what group benefits more from the first.

Ms. FAGNONI. Right. Exactly. If you look at the entire package. Right.

Mr. MATSUI. Because death will bring additional benefits.

Ms. FAGNONI. Our main point in pointing that out is that this is——

Mr. MATSUI. And I'm just trying to understand this.

Ms. FAGNONI [continuing]. Is that this isn't just a retirement program——

Mr. MATSUI. Yes. Right.

Ms. FAGNONI. And there are other benefits that they draw on.

Mr. MATSUI. I mean, just anecdotally looking at this, it's pretty obvious to me and I obviously await your final report. But it's pretty obvious to me that the minority population generally benefits disproportionately than the population as whole for Social Security benefits. Can you at least give me a preliminary indication of whether that statement is correct?

Ms. FAGNONI. Yes, again, the research generally supports that statement.

Mr. MATSUI. That statement.

Ms. FAGNONI. Right.

Mr. MATSUI. So that's an accurate statement. So, the fact that a individual might die at the age of 60 is not necessarily of any relevance in terms of the overall conclusion you're reaching?

Ms. FAGNONI. Anytime, one looks at an average, there—the individual circumstances vary so much that you'd really want to look at what proportion of people would fall into those specific categories.

Mr. MATSUI. Right. So if I can generally conclude, and obviously, we need—I'm sorry, Mr. Chair, I know we have a time constraint here. If we can conclude that the current system benefits minorities disproportionately compared to the general population.

I want to move over to another issue. Shall I come back with it?

Chairman SHAW. How much time was left on the vote? Seven minutes. All right go ahead, Mr. Matsui.

Mr. MATSUI. Maybe I can—now, I want to talk about the individual accounts. Now, your preliminary comments on individual accounts are that low-income categories, which minorities are predominantly in, compared to the general population, have a more difficult investment pattern. They invest more conservatively because obviously they don't have other assets to overcome more risky investments, so their rate of return is lower.

And second, which I think is perhaps of equal importance, they may not have the kind of financial background to make these investments. I know you didn't really address that issue, but are you going to address that in the final report? What's your preliminary?

Ms. FAGNONI. Well, actually, we did talk about the fact that they are less likely to have any kind of savings vehicle, and this does raise important questions about how do you help people like that—with education and understanding of making investment decisions.

Mr. MATSUI. What I would hope, too, is that in your report, in your final report, you might try to address—if you can—I don't even know if it's appropriate because that may not be part of your challenge, but address the issue of cost of maintenance of the program—I mean, since low-income people obviously have less money in their accounts and then, you know, more of it is eaten up by financial advisors than, let's say, somebody who is wealthier and obviously has a greater wherewithal. Perhaps you can just respond to that.

Ms. FAGNONI. We actually have another line of work where we're really looking specifically at the implementation issues associated with individual accounts, and one of the most important aspects of that is administrative costs, and how do you deal with things like the small accounts. And what might be done to reduce administrative costs on those types of accounts.

Mr. MATSUI. Thank you very much.

Chairman SHAW. OK, we will recess for approximately 15 minutes so the Members can vote. This will be the only vote that will disrupt our hearing today.

[Recess.]

I'll go ahead with my area of questioning, because I want to follow up. I think the previous questioners were closing in on something that I think this Subcommittee is going to have to take a close look at; and that is with regard to if we would go to some type of public investment in the private sector that we've got to be sure that if we do it on an individual basis that the individuals are sufficiently protected from their own, their own possible problems, and that these accounts are kept for retirement and for retirement only.

Mr. Hulshof was getting into an area which I think is troubling when you're talking about minorities. There is no, as you well know, there is no vested interest and the courts have said so in the Social Security system. Even though you pay in all your life, not voluntarily but compulsory—you're employer pays in for you. If you die, it's tough. You have nothing left. You have not accumulated any wealth at all. And despite the fact that the minorities might do better as far as disability-type or survivor-type of benefits, it's plain and simple that they do worse as far as retirement. They generally go to work earlier, at a younger age, and they die younger, which sort of gives them a double whammy, which is something I'm concerned about, and I would guess that all of us here on this Subcommittee, are also concerned about.

Going back to your testimony and talking about general investment principles and financial planning advice would be essential in helping all investors to better manage their accounts. I think that would apply to all of us, whether we're college-educated or whether we have a high school degree; that we would certainly not want to allow whimsical type of investment with your brother-in-law or something, or on a stock tip that you happened to hear walking into the building this morning or up the elevator or something of that nature. And I'm sure you can foresee a plan where you can't have insulation with regard to that.

Also, the question of the administrative costs. You wouldn't formulate a plan where someone who is close to minimum wage, or even with an income under $20,000 would have to have their own investment counselor setting up their account individually and managing it on an individual basis, because it's simply—the administrative cost would simply pretty much wipe out the principal. It will take just too much of it. But obviously, you can have investment pools where this could be very beneficial.

Do you see any problems with what I have just said?

Ms. FAGNONI. Well, to your first point about everybody needing education and investment advice. That's certainly going to be true if there is any individual account feature.

But our point was to note that that's especially true for people who may not have made investments before and may not have quite the educational level that others might. So, it becomes especially important that any kind of program that might be set up thinks carefully about how to help people understand what it is they would be doing. And, of course, you could structure the program. That's why we're doing some of the work we're doing right now, looking at the different issues related to implementing individual accounts, to look at what do you do with the small accounts? Are there ways to pool so that you can reduce administrative costs?

Those sorts of issues. There's a tradeoff between giving people more choices and more freedom versus fewer choices and perhaps more protections against riskier or unwise choices.

So there are a lot of decisions that would need to be made about how to best structure those kinds of plans.

Chairman SHAW. I think it would mainly be in spreading the risk across many investments, many type of investments. And also, the question of what do you do when someone retires and if they do have an individual account, what if the stock market is in a free fall at that particular time, how would you handle that?

Ms. FAGNONI. Right.

Chairman SHAW. And those are things that this Subcommittee is going to have to take a very hard look at.

But you did, quite correctly, note that over a long period of time, and all through our history, even in times that bridge the thirties and the Great Depression, that the investment in the private sector, over the long haul, was certainly paid substantially better than what we're getting now. It's just the interest off the T-bills, is that correct?

Ms. FAGNONI. Yes.

Chairman SHAW. So, if we can find some way to protect the worker in that area and protect the worker against himself, really, or herself, with regard to the type of investments that these things are worth looking at, wouldn't you agree with that?

Ms. FAGNONI. Well, in terms of timing, as you mentioned, I'm sure you know the story in Chile where the head of the retirement plan suggested that people hold off retiring because the stock market wasn't looking so good at the moment, and I'm not sure how well that would go over in this country. So there would be a lot of issues to consider.

Chairman SHAW. In my district, it wouldn't go over well at all.

Ms. FAGNONI. I wouldn't think so.

Chairman SHAW. But I would suggest that if we did put some kind of a safety net in there, in the legislation, that we wouldn't— that we could tell someone very well that you could put off retirement if you want to, but these basic benefits are still in place for you so that there's some type of guarantee, and I don't believe there is in the Chilean model. Isn't that correct?

Ms. FAGNONI. Yes, I believe that's correct.

Chairman SHAW. So if we could, if we could put some kind of a guarantee in there that this would eliminate that objection or that concern.

Ms. FAGNONI. And you raise another good point that——

Chairman SHAW. Quite obviously, it would.

Ms. FAGNONI [continuing]. It's important that people really know if there were to be a new sort of system that included individual accounts that it's very clear to people up front what they do and don't do, and what is and isn't protected under that kind of structure.

Chairman SHAW. OK. Now, in your testimony, you have not addressed, at least I don't believe you did, you haven't addressed the President's plan. Is that right?

Ms. FAGNONI. No, not in this testimony. As you know, Mr. Walker testified yesterday about that issue.

Chairman SHAW. And I believe Mr. Walker is going to be testifying before the Full Committee on Monday, so I won't get into that area right now.

Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman. Actually, you got into many of the aspects of the testimony that I wanted to investigate, particularly the one concerning education of investors, education of the population with respect to their investment choices. And I think you all talked about that enough. Suffice it to say that I don't think, Ms. Fagnoni, that your testimony is that the education need or the education component of this is a showstopper; that we just have to be mindful of the fact that there are going to be consumers, potential retirees out there that are not going to be sufficiently educated at the outset with respect to a wide range of investment choices; and that we have to be careful in how we package that element of the Social Security Program if we chose to make individual accounts an element of the Social Security Program. Is that a fair statement?

Ms. FAGNONI. That's correct. Yes.

Mr. MCCRERY. OK. Thank you, Mr. Chairman.

Chairman SHAW. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman. I find this testimony very informative. On one hand, the current Social Security progressive benefit formula is of greater value, as you point out in your testimony, to low-paid workers. If you were to replace part of that benefit with private accounts, and do nothing else, the propensity of low-wage workers is to make more conservative investments, and the disparity would probably just grow if that's all you did?

Ms. FAGNONI. Particularly if you were to structure something that cut into existing benefits. That's something you'd want to look very carefully at. Right.

Mr. CARDIN. But on the other hand, if we do something to supplement the current benefits, as the President is suggesting in his Universal Savings Accounts, that provides protection as to the types of investments that individuals could invest in, greater education on the benefits of long-term accumulations through higher rates of return, and deals with the administrative costs, which I think you pointed out in your direct testimony, then we might reduce the wealth disparity among retired people, if we can get low-wage workers more engaged in private retirement?

Ms. FAGNONI. I think there is that potential as long as the structure of the system is carefully considered, and it's recognized the types of benefits that particularly low-income individuals may need to draw from, such as disability and survivors insurance as well as retirement.

Mr. CARDIN. No, we're all very mindful of how the structure is configured. I think you make a very good point about that. Though, I think the key here is that if you were to replace the current progressive protection, you run much greater risk than if you can do something on top of the current system. And we need to do a better job, particularly with low-wage workers, of taking advantage of greater rates of return for private retirement. Right now, they're not participating, as I understand. And when they do participate, they're participating in lower rates of return because of an education factor, at least as your testimony points out.

Ms. FAGNONI. That's right.

Mr. CARDIN. Thank you, Mr. Chairman.

Chairman SHAW. Mr. Hayworth.

Mr. HAYWORTH. Mr. Chairman, I thank the witnesses. I have no questions at this time. Thank you, sir.

Chairman SHAW. Mr. Levin.

Mr. LEVIN. Thank you. Just a couple of quick ones. I'll try to resist dragging you into the general debate. It's tempting. But I will focus on your testimony.

Did the results surprise you?

Ms. FAGNONI. Well, I think the place where there's the most controversy or discussion is we know that low-income people benefit from the progressive formula that Social Security has. One the other hand, we know that groups who don't live as long, for example, blacks, on average at least, that that works against them. So the difficulty is in what is the whole package look like and how does that package of benefits compare to the contributions. So while the individual elements were not surprising, I think we still have some work to do to more specifically demonstrate the overall contributions to the overall benefits. But I believe that given the demographic characteristics of certain groups of minorities, some of these results are not surprising. Because, as we point out, it's not the race or ethnicity itself, it's the characteristics of individuals and how those play out under the current Social Security structure that makes the difference.

Mr. LEVIN. Are you pretty sure of your tentative results? Do you expect that they will be challenged?

Ms. FAGNONI. I know there are some questions about—there have been different studies that question how good a deal, quote unquote, blacks are getting from the current system. But the research, to date, has tended not to focus on the disability and survivors benefits as part of that package. And we think it's important to look at the whole package, given how important those benefits are to certain minorities.

Mr. MULVEY. The report that I mentioned that we're working on is looking at a new dataset, which matches SSA data with data from the survey that we're using, which we believe will give us a much better understanding of the overall rates of return to whites versus blacks and other groups. And as I said earlier, we hope to have that out later on this summer.

Mr. LEVIN. Are you pretty confident of your methodology?

Mr. MULVEY. Well, we have had a lot of review of the methodology. We spent a lot of time working on it and getting access to these data. It's a very desirable dataset, which is guarded very carefully by Census because of the confidentiality of the data. We are pretty confident that we're taking the right approach.

Mr. LEVIN. One last question. Because there's been some discussion here concerning people who pass away at 60 if they are single they receive no Social Security benefits, this structure has been in place now 60 years, hasn't it?

Ms. FAGNONI. That's right.

Mr. LEVIN. And in that respect, there's been no change.

Ms. FAGNONI. That's correct.

Mr. LEVIN. And yet surveys show that the present system is exceptionally popular, isn't that true?

Ms. FAGNONI. It's always considered one of the most popular, one of the most successful if not the most successful social program that this country has enacted. I think you have to be careful when you look at a specific scenario, because, overall, if you look at population characteristics, there are lot of people who do make it to retirement age; and a lot of people who need and want the protections against early death or disability that Social Security provides.

Mr. LEVIN. So maybe it reflects the fact that there's an insurance aspect to this. It's securing certain guarantees. And it's somewhat understood that if you're single and don't survive to age 60, you would have helped somebody else. That's true of every type of insurance plan isn't it?

Ms. FAGNONI. That's true, although I'm sure for the individuals I would suspect they always hope they'll be the ones who benefit. And we don't know.

Mr. LEVIN. All right, we don't know.

Ms. FAGNONI. If we knew, we wouldn't need insurance.

Mr. LEVIN. We always hope the fire isn't in our house.

Thank you.

Chairman SHAW. Mr. Portman.

Mr. PORTMAN. I thank the Chairman, and I'm sorry I wasn't here for all of your testimony. I am very interested in the topic, and have looked at your summary conclusions on your report.

I guess I have a couple of questions just to clarify where we are. Following on Mr. Cardin's question with regard to the current benefits structure, which has been talked about as a progressive benefits structure in the sense that so long as people are living the same amount of time, low-income people would get a better return on the amount that they've put into the system defined that way.

I think we also realize that there's a tremendous solvency crisis ahead of us, and by 2032, I think you would agree, that we either have to increase payroll taxes by 40 or 50 percent or we have to cut benefits by, I don't know, 25 percent, is that fair?

Ms. FAGNONI. Well, we are on record as saying that because there's a solvency problem, it's important to take action sooner rather than later, because then you don't have to take such draconian steps.

Mr. PORTMAN. Exactly.

Ms. FAGNONI. To——

Mr. PORTMAN. And, you know, those are some of the parameters within which we are working. And then the question comes up: how do you get that higher rate of return? We've gone through this debate on whether there will be direct investment by the trust fund or whether it be individually directed.

And again, following on Mr. Cardin's question, I understand what you're saying about the potential of low-wage workers being more conservative in their investment decisions and perhaps not getting as high a rate of return on the individual accounts or any kind of directed account, whether it's credited to Social Security or whether it's a so-called individual account. And yet, I just keep coming back to the fact that we need to compare those to where we are. And the question I would have to you would be in any of your research did you determine whether folks who, indeed, did chose to opt with some percentage of payroll tax, for instance, or even through a USA-type account, which is really separate from Social Security, as compared to the return they would get under current law, even if they are low-income workers and regardless of the ethnicity or race, isn't based on a 50-year average or based on a 75-year average, but certainly based on a decade average, wouldn't they do better making even conservative investments on the whole?

Ms. FAGNONI. I think that really ends up depending on their individual circumstances, because of the certain features of the Social Security Program, people who are lower income but also are married, who are one-earner families, there are certain kinds of individuals who benefit more under the current Social Security structure. You'd have to take that into account in looking at comparisons.

Mr. PORTMAN. But even taking that into account—I understand you have to do that—and I'm trying to get some sort of "on average." So, despite those characteristics, still in terms of the return, I think we have to keep in mind here that we're talking about a return of about 2.9 percent, assuming the trust fund really is a Trust Fund and all those problems we have about dealing with the trust fund assets as we get into the baby boom retirement years. And will it be there.

But let's assume it is. Still, even if the investment is made in a relatively conservative way, let's say, in a bond fund, as opposed to an equity fund, isn't it true that the return is going to be greater just based on historical data? I think it's a yes or no answer.

Mr. MULVEY. Well, we are just finishing up a report looking at what happened in Texas, which we expect to be releasing very shortly. And while we can't discuss the final results of that report, because it hasn't been released, we can say at least, as Ms. Fagnoni said, it does depend to some extent on individual circumstances. And while——

Mr. PORTMAN. And, you know, obviously, it depends on——

Mr. MULVEY [continuing]. Total return to the whole group might be somewhat higher. There's certainly different patterns for different demographic subgroups. And I think what this hearing is about, as was the one last week on women, is that there are certain groups of the population you're particularly concerned with because the implications for them might be greater. And if that is the case more than for the group as a whole. And what might you do to protect those, protect those groups.

Mr. PORTMAN. I think it's valid. It's very important information you're providing us and my only caution would be let's be sure we're talking about what we might be moving into as compared to the current system. When you do the analysis, for instance, in your report on African-Americans as a group and how they would benefit from the current system versus a system where some percentage of that payroll, not all of it, there would still be a floor, I think one has to take into account the fact that there does tend to be less of a benefit now accruing because of longevity, because of other factors that, as you said earlier, are characteristics, and, you know, I hope we're not, you know, one doesn't want to generalize, and yet you have in your report because necessarily that's what you're looking at. And my only observation is we need to compare what that same group, even if they don't have the same benefit as another group, under a system where there's some ability to direct accounts, what that group would get as compared to the current system, which is really what we're stuck with. And that's all I would caution against. It's not so much to make this a question of fairness as between groups, but fairness as between the current system and what it could be.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Doggett.

Mr. DOGGETT. Well, of course, we like to think all our ideas down in Texas are a little better than any other place, but I understand the preliminary work that you've done here, this Galveston plan and some of these alternative plans have worked better for high-wage earners, but they haven't worked out as well as Social Security for low-wage workers.

Mr. MULVEY. Well, as I said, we haven't released the report yet, so I can't be final on that, but as you might expect, any plan that would rely upon individual accounts and that doesn't have the tilt in the benefit formula that Social Security does, would give greater benefits to high-wage workers than to low-wage workers.

The question I guess is whether or not everybody benefits, but the benefits are just unevenly distributed.

Mr. DOGGETT. And then if I might ask you if our choices are between preserving and protecting the current Social Security system versus the approach that our initial expert witness to this Subcommittee provided the other day that we should have abandoned Social Security a long time ago, and gone with an individual retirement system—do I read your conclusions to be that doing the latter will have a disproportionately negative effect on African-Americans and Hispanic-Americans.

Ms. FAGNONI. I think first of all to put it in that dichotomy, I think there's room somewhere in the middle in terms of for whom the benefit formula is important. The auxiliary benefits are important, but it's also important to consider whether there is a way to achieve higher rates of return on some portion of the benefits as long as there is a level of protection for individuals. So I'd hate to see it be all protection, all private, and not something in between.

Mr. DOGGETT. And certainly, I hope there are some other alternatives as well. But if those are the two choices for African-Americans and Hispanic-Americans as a group, the choice is pretty clear.

Ms. FAGNONI. Clearly, they have benefited especially from the social insurance features, the disability benefits, the survivors benefits, as well as for those who reach retirement age, the retirement benefits, and the tilt in the benefit formula toward low-paid workers.

Mr. DOGGETT. And if I understand your testimony correctly, one of the reasons why that is true is because of the differing investment behavior of workers at low-income levels?

Ms. FAGNONI. Well, I think it starts from how much they've benefited from certain features of the Social Security Program. What we tried to do in looking at investment behavior is tried to look at well, if you did restructure, kept some kind of defined benefit component, but then also included individual accounts, what might the investment pattern look like? And what does that tell you that you need to think about if you move in that direction?

Mr. DOGGETT. And what it told you was that there was a need for more investor education?

Ms. FAGNONI. Yes.

Mr. DOGGETT. And what experience have we had in educating people as to anything similar that GAO might have analyzed and how successful it would be—it has been?

Ms. FAGNONI. Well, we haven't really done analysis. But we did do a little bit of checking. I mean, there are some examples from the 401(k) plan experiences, where companies have taken certain actions to try to educate employees with respect to the investments they might make under the 401(k) plan—publishing brochures, holding seminars, having interactive, computer-types of programs, kiosks. I mean, there are lot of different programs and approaches out there in the private sector that might be worth taking a look at, if one were to move in that direction of individual account components.

Mr. DOGGETT. Are there studies available to show, for example, under 401(k) plans whether there is a disparity there in utilization of those plans depending upon the economic level of the worker?

Mr. MULVEY. I'm not sure. We've done some work on 401(k) plans, and we looked fairly recently at the borrowing behavior of individuals. I have to go back and see what kind of data there are on their investment behavior. They are doing some work on the TSP, showing how people in the TSP Program invest, how their investment behavior differs by ethnic group, by race, by sex, and so forth.

Mr. DOGGETT. Has there been any GAO studies, for example, of the success or lack of success in making individuals aware of free subsidized health insurance under our Children's Health Insurance Program?

Ms. FAGNONI. Not to my knowledge.

Mr. MULVEY. Not to my knowledge.

Mr. DOGGETT. Not your area? Might you elaborate on the observation that you made in response to the Chairman's question about the experience in Chile with—we've often seen in some of the reports Chile extolled as an example of what we should follow here—what the experience there was?

Ms. FAGNONI. Well, my point in telling that story was that for a number of years the stock market was very robust, and people were getting high rates of return. And even though the Chilean system has fairly high administrative costs, it was looking good for people. But it served as a cautionary note when the head of the program had to suggest that people delay retirement, because that just points out the issue related to timing; and when you take your annuity or lump sum benefit, if you've got that choice, if you happen to do that at a point in time when the market has turned down. I mean, clearly, history shows that over the long run, equities provide a fairly high rate of return—7 percent, and inflation adjusted.

But the issue of what happens to an individual who retires at a specific time is—again, just a cautionary note about how such a system might be managed.

Mr. DOGGETT. Thank you, Mr. Chairman.

Chairman SHAW. Mr. Johnson.

Mr. JOHNSON of Texas. Thank you, Mr. Chairman. I'd like to follow up on that questioning a little bit. You stated that the minorities are at a disadvantage if we restructure the system. However, you also made the statement that you hadn't compared it with anything. Is that true or false?

Ms. FAGNONI. Well, our point in talking about restructuring is—we didn't directly say that they're at a—our point was to talk about how they might invest assets if they were given that opportunity——

Mr. JOHNSON of Texas. Then you said they weren't smart enough to invest them.

Ms. FAGNONI. Well, what we—what it shows was those who invest, invest more conservatively. But we also noted that the data show that people with lower incomes and less years of education are less likely to have made investments at all, and so that raises some questions.

Mr. JOHNSON of Texas. Yes, you say the data, where did you get the data?

Ms. FAGNONI. This is data from looking at Social Security Administration data and national——

Mr. JOHNSON of Texas. Social Security is what we're talking about——

Ms. FAGNONI [continuing]. National survey data.

Mr. JOHNSON of Texas. Did you perchance take a look at the thrift savings plan that we have here in the Congress, and we do have some minorities involved in that, do we not?

Ms. FAGNONI. Yes.

Mr. JOHNSON of Texas. Did you?

Ms. FAGNONI. Well, our primary data source was a national survey, the Survey of Income and Program Participation because it allowed us to look more specifically at minorities. The thrift savings plan is for government workers and is a—we were not able to do the kinds of analyses that——

Mr. JOHNSON of Texas. So you're saying that the minorities in the government are better than the minorities in the Social Security system? True or false?

Ms. FAGNONI. No, that's not what I am saying.

Mr. JOHNSON of Texas. Tell me what you're saying.

Ms. FAGNONI. We were unable to examine the thrift savings plan data because it didn't allow us to look more specifically at the details of different subpopulations, so we used a broader national survey dataset that allowed us to look at different patterns.

Mr. JOHNSON of Texas. Yes, who did that?

Ms. FAGNONI. This was a Census Bureau dataset.

Mr. JOHNSON of Texas. A Census Bureau study. And you said you studied some 401(k) plans, whose did you use?

Ms. FAGNONI. Well, the 401(k) plans, this is——

Mr. MULVEY. That's a HRS survey, I believe. It was the 401(k) plans. That's another dataset that I believe the University of Michigan——

Ms. FAGNONI. University of Michigan——

Mr. MULVEY [continuing]. Is the one that has those data.

Mr. JOHNSON of Texas. Are those recognized studies that everyone uses?

Mr. MULVEY. Yes.

Mr. JOHNSON of Texas. And what are the dates on them? How old are they, in other words?

Mr. MULVEY. The HRS is updated fairly frequently. I'd have to get that for you with the date of the dataset.

[The following was subsequently received:]

We used two data sets to do the 401(k) analysis. the first was the Health and Retirement Survey, prepared by the University of Michigan Survey Research Center in 1992. The second was the Survey of Consumer Finance, prepared by the Federal Reserve in 1992. We used one data set to do the analysis of investment patterns by race. it was the Survey of Income and Program Participation, prepared by the Bureau of the Census in 1992–93.

Mr. JOHNSON of Texas. Yes, well, I think your conclusions are a little bit suspect in your answers to Mr. Doggett and some of the others on this Subcommittee. And I think that if you all can substantiate your findings with reference to precise data I think it would be appreciated.

Thank you very much.

Chairman SHAW. Thank you. Ms. Fagnoni, do you know of any other pension plan that only invests in Treasury Bills?

Ms. FAGNONI. No.

Chairman SHAW. Social Security is the only major retirement plan in this country that only invests in Treasury Bills?

Mr. MULVEY. Well, these are special Treasuries—nonmarketable special Treasuries——

Chairman SHAW. I'm sure they're special, but they base——

Ms. FAGNONI. That's true.

Chairman SHAW [continuing]. But they pay you regular interest rate, which is a damned bad rate of return when you compare it to how other pension plans are performing.

Now, let me ask you, let me ask you one—do you have children?

Ms. FAGNONI. Yes.

Chairman SHAW. How old are they?

Ms. FAGNONI. I have a 7-year-old son.

Chairman SHAW. All right. I'm about to throw you a curve ball. Would you advise your 7-year-old son to enroll in the Social Security Program at his age when he gets into the work force, or if he had a choice to get into some other plan, how would you advise him?

Ms. FAGNONI. Well, I would have to say that I have faith that policymakers will, will——

Chairman SHAW. You're lying. [Laughter.]

Ms. FAGNONI [continuing]. Will be able to restore solvency to the Social Security Program in a way that it would be there for him.

Chairman SHAW. Right. OK. Well let me let you go home and assure your son that that's exactly what we're going to do. We are.

Ms. FAGNONI. Thank you.

Chairman SHAW. And I thank you for your testimony.

Mr. MULVEY. Thank you.

Chairman SHAW. Thank you.

All right. The first thing I'm going to do is ask the next panel to come back and correct me on my pronunciation of all of your names.

Mr. Robert Garcia de Posada. Now, that's coming—that's reaching back into high school Spanish—executive director of the Hispanic Business Roundtable. William E. Spriggs, Ph.D. He is the director of research and public policy of the National Urban League. Kilo—oh, boy. Kijakazi. Thank you. Senior policy analyst, the Center on Budget and Policy Priorities. Eric Rodrıguez, who is a senior policy analyst, the National Council of La Raza, and William W. Beach, director, Center for Data Analysis, Heritage Foundation.

We welcome all of you. We have your full statements that will be made part of the record, and we would you invite you to summarize as you see fit.

Mr. de Posada.

STATEMENT OF ROBERT GARCIA DE POSADA, EXECUTIVE DIRECTOR, HISPANIC BUSINESS ROUNDTABLE, ALEXANDRIA, VIRGINIA

Mr. DE POSADA. Thank you, Mr. Chairman.

My name is Robert Garcia de Posada. You pronounced it right. I am the executive director to the Hispanic Business Roundtable. Hispanic Business Roundtable was created in 1995 to address policy issues that affect the well-being of Hispanics.

The creation of these personal retirement accounts is one of those issues we believe will build family wealth and will raise the standard living of the low-income Hispanic family.

Hispanics are the fastest growing segment of the work force. Hispanic businesses are also the fastest growing segment of our economy. And according to the U.S. Census, currently 66 percent of Hispanic population is under the age of 35.

The Census also shows that by the year 2030, 25 percent of the American working population will be Hispanic. As such, 30 years from now Hispanic workers will disproportionately carry the burden of our retirement system. This is why Social Security reform is so important to the U.S. Hispanic community.

On the one hand, it will directly affect the 1.5 million Hispanic-owned businesses which will have to pay higher taxes if nothing is done.

And yet on the other hand, under the current system, in 30 years, the tax burden will be felt disproportionately by millions of a young Hispanic workers.

U.S. Hispanics have larger families, lower incomes, and are generally younger than the general population. Studies show the current system's rate of return for Hispanics will be significantly less than what they could generate under conservative private investment.

If Hispanics were allowed to direct the employee portion of their payroll taxes into safe investment accounts, or in U.S. Treasury bonds, they could nearly double the rate of return they currently receive under the Social Security system. For example, in Galveston, Texas, where county government workers have a private, a full private plan, an employee making $20,000 per year will collect a lifetime monthly benefit at retirement at $2,740. Under the current Social Security system, the comparable benefit per month is only $800. This makes an additional $1,900 per month for a retiree.

Also, under the Galveston plan, if a worker dies before retirement his or her heirs can collect between $50,000 and $150,000, money that could be used to help family members improve their lives, such as by going to college or starting a new business.

Under the current Social Security system, the maximum death benefit is a lump sum of only $253, money that won't even cover the college textbooks.

The balance of the money paid into the Social Security system is lost. I know this firsthand because my father died when I was 16.

I am sure there are flaws in the Galveston plan. However, studying the pros and cons could be a great start. Those who oppose the private retirement accounts system, stating that low-income families have no experience in investing and the brokers will not be interested in accounts of $100 per month or less. As arrogant as this might sound, we should address this concern.

There are ways low-income individuals can be brought into the system with everybody benefiting. We need to look at consumer education and attract community-based organizations, cooperatives and local governments to pool workers' retirement income together to attract these brokers and investors. For example, strong and established organizations like the Americans Association of Retired Persons to pool income from their members and their families into these personal retirement accounts.

Just imagine the possibilities. More people buying Treasury bonds and investing in the stock market. Low-income children learning about the market and pursuing careers in this field. All in all, more money available to help low-income families escape the vicious cycle of poverty and inequity.

We can reform to save Social Security, but we need to do it now. However, we cannot do this by raising taxes on businesses and workers and cutting benefits. And we certainly cannot continue to ignore the problem by using accounting gimmicks.

If we want real reform, personal retirement accounts must be one of the choices available to those affected by the system. It should be an individual choice, because it's their risk and it's their money. Without a doubt, private retirement accounts will increase the rate of return on retirement income, and, therefore, put more money into people's pockets. But most importantly, a more profitable retirement system will generate greater family wealth, especially in the Hispanic community, and our community desperately needs this.

Thank you.

[The prepared statement follows:]

Statement of Robert Garcia de Posada, Executive Director, Hispanic Business Roundtable, Alexandria, Virginia

My name is Robert Garcia de Posada, and I am the Executive Director of the Hispanic Business Roundtable. The Hispanic Business Roundtable was established in 1995 to address policy issues that directly affect the well-being of Hispanics in the

U.S. The Roundtable's agenda is to develop and promote policies that will enhance overall business, economic and social development of Hispanics, and to empower those individuals through the promotion of self-reliance and personal responsibility.

The creation of personal retirement accounts is one of those issues we believe will help generate family wealth and raise the standard of living of low-income families.

Hispanics are the fastest growing segment of the workforce. Hispanic-owned businesses are also the fastest-growing segment of our economy. According to the U.S. Census, currently 66% of the U.S. Hispanic population is under the age of 35. The Census also shows that by the year 2030, 25% of the working American population will be Hispanic. As such, 30 years from now, Hispanic workers will disproportionately carry the burden of our retirement system.

This is why real Social Security reform is so important to the U.S. Hispanic community. On the one hand, it will directly affect the 1.5 million Hispanic-owned businesses, which will have to pay higher taxes if nothing is done. Yet on the other hand, under the current system, in 30 years the tax burden will be felt disproportionately by millions of young Hispanic workers.

U.S. Hispanics have larger families, lower incomes and are generally younger than the general population. Studies show the current system's rate of return for Hispanics will be significantly less than what they could generate under conservative private investments. If Hispanics were allowed to direct their payroll taxes into safe investment accounts or into U.S. Treasury bonds, they would nearly double the rate of return they currently receive under the Social Security system.

For example, in Galveston, Texas, where county government workers have a full private plan, an employee making $20,000 per year will collect a lifetime monthly benefit at retirement of $2,740. Under the current Social Security system, the comparable benefit per month is only $800. This means an additional $1,900 per month for a retiree.

Also under the Galveston plan, if a worker dies before retirement, his or her heirs can collect between $50,000 to $150,000—money that could be used to help family members improve their lives such as going to college or starting a new business. Under the current Social Security system, the maximum death benefit is a lump sum of only $253.00—money that won't even pay for college text books. The balance of the money paid into the Social Security system is lost.

There are those who oppose private retirement accounts stating that low-income families have no experience in investing and that brokers will not be interested in accounts of $100 or less per month. As arrogant as this might sound, we should address this concern.

There are ways low-income individuals can be brought into the system with everybody benefiting. We need to look at consumer education and attract community-based organizations, cooperatives and local governments to pool workers' retirement income to attract brokers and investors. For example, we need strong and established organizations, like the American Association of Retired Persons, to pool income from members and their families into personal retirement accounts.

Just imagine the possibilities. More people buying Treasury Bonds and investing in the stock market. Low-income children learning about the market and pursuing careers in this field. All in all, more money available to help low-income families escape the vicious cycle of poverty and inequity.

We can reform and save Social Security, but we need to do it now. However, we cannot do this by raising taxes on businesses and workers and cutting benefits. And we certainly cannot continue to ignore the problem by using accounting gimmicks. If we want real reform, personal retirement accounts must be one of the choices available to those affected by the system. It should be an individual choice; because it's their risk; and their money.

Without a doubt, private retirement accounts will increase the rate of return on retirement income and therefore put more money into peoples' pockets. But most importantly, a more profitable retirement system will generate greater family wealth, especially in the Hispanic community. And our community desperately needs this.

Thank you.

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Chairman SHAW. Mr. Spriggs.

STATEMENT OF WILLIAM E. SPRIGGS, PH.D., DIRECTOR, RESEARCH AND PUBLIC POLICY, NATIONAL URBAN LEAGUE

Mr. SPRIGGS. Thank you, Mr. Chairman, for the opportunity to testify. And I appreciated the invitation because I remember meeting you at the White House Conference, and I certainly enjoyed the openness that you had at that conference.

My name is Dr. William Spriggs. I am the director of research and public policy for the National Urban League. I'm here to represent Hugh Price, who is our president.

Founded in 1910, the National Urban League is the premier social service and civil rights organization in America. Headquartered in New York, we are a nonprofit, nonpartisan, community-based movement with 114 affiliates in 34 States and the District of Columbia.

The mission of the Urban League movement is to help African-Americans attain social and economic equality. The fundamental objective of the National Urban League is to enable those who are striving toward the mainstream to achieve economic self-reliance and enjoy their rights as equal citizens under law.

In that context, we are extremely concerned about Social Security reform. This is a very important debate, affecting the lives of African-American retirees, children and disabled workers.

The primary concerns of the National Urban League are that the program not lose its progressive benefit structure; maintain adequate levels of support for disabled workers; continue to provide benefits to spouses after divorce or separation; and provide for early retirement at age 62. The National Urban League signed onto the principles of the New Century Alliance for Social Security to set forth goals for reforming Social Security. Fellow signers include the NAACP, the Rainbow-Push Coalition, the National Council of Negro Women, the Children's Defense Fund, and the National Organization for Women.

Currently, Social Security, whose program's formal name, the Old Age, Survivors, and Disability Insurance Program replaces more of the wages of workers who had low earnings during their work careers than high-wage workers. African-Americans, because of continued effects of discrimination, are disproportionately among low-wage workers.

Let me say that we support and are very happy with the path that the President has laid out for trying to save Social Security. It has certainly made the problem smaller. We think that we should look seriously at the ability of the fund to invest in the equities market.

Having said that and applauding the downpayment that the President made to shrink the problem, we know that there are tough choices ahead, and we're willing to work to make those choices.

We further applaud the President for announcing a program of savings accounts. African-Americans need the third leg in a retirement program. That third leg is missing for most African-Americans, because of continued discrimination in the labor market that cuts us off from private pensions.

So, those who are concerned about savings for retirement, I think, should be encouraged, as we are, by the path that the President has laid to talk about the gap that we have in the private pension market.

Debating Social Security drops the program's formal name. And what's in the name? Well, you have survivors and disability. It's not just old age. Even the tax is called the Federal Insurance Contribution Act. As an insurance product, the OASD insurance is unique because it insures families. The benefits of the programs are not just for the worker, but for the worker's dependents and spouse. That makes the program very complex and difficult to assess when viewed as only an annuity program for a worker. Calculations of rates of return on the program miss that point.

When viewed as an insurance program, the rate of return calculations for the program look different for whites and African-Americans. African-Americans, as you heard in the earlier panel, disproportionately benefit from the current structure of the insurance program. An analysis of benefits paid relative to taxes paid shows that, on net, African-American families have received more benefits than were paid in taxes.

In the private market, insurance premiums tend to exceed benefit disbursements. This is because of the progressive nature of the benefits that African-Americans benefit and because it insures families.

Many aspects of this OASD Insurance Program would be unavailable to African-American families in the private market. Disability insurance would be difficult to find. And so we think that it is necessary to think of this in its more complex form.

As you think of ways of saving the program, we hope that you will not include provisions that would diminish the ability of workers to retire early. This especially concerns our ability to find work for those who are healthy and want to find jobs, but find it very difficult in the low-wage market; and those who have not acquired a lot of skills.

In closing, the broad-based support for the program comes from the many ways it touches the lives of American families. For some families, it the receipt of disability benefits. For some, it is the receipt of dependent survivor benefits. For some, it is the receipt of old age retirement benefits. For each family, a different need is met.

A program which separated the treatment of retirement from the family insurance portion of the program would not have such a universal family focus. A program that separated the individual worker and placed the risk of a decent retirement lifestyle on the individual and so we move the assurance of the program because of its insurance nature would not have such a universal family focus.

The issues facing Social Security face all Americans. The National Urban League hopes that solutions can consider all Americans. Americans who are disabled, Americans who are spouses of retired workers, Americans who are dependents of workers, and Americans who survive workers all need to be considered. We think Americans value most the safety net of Social Security. Changing the philosophy of the program would remove the moral underpinnings that Americans value.

[The prepared statement follows:]

Statement of William E. Spriggs, Ph.D., Director, Research and Public Policy, National Urban League

Thank you, Mr. Chairman for the opportunity to testify before the Subcommittee on Social Security of the House Ways and Means Committee. My name is Dr. William Spriggs, and I am the Director of the Research and Public Policy office of the National Urban League (NUL). I am here today on behalf of Hugh Price, President and Chief Executive Officer of the National Urban League.

Founded in 1910, the NUL is the premier social service and civil rights organization in America. Headquartered in New York City, with an office strategically located in Washington, D.C., the League is a nonprofit, nonpartisan, community-based movement with 114 affiliates in 34 states and the District of Columbia.

The mission of the Urban League movement is to help African Americans attain social and economic equality. The fundamental objective of the NUL is to enable those who are striving toward the mainstream to achieve economic self-reliance and to enjoy their rights as equal citizens under the law.

In that context, we are extremely concerned about Social Security reform. This is a very important debate, affecting the lives of African American retirees, children and disabled workers. The line between poverty and meager subsistence depends on the outcome of this debate. Few issues could be more important when the gap between the rich and poor is widening.

The primary concerns of the NUL are that the program not lose its progressive benefit structure; maintain adequate levels of support for disabled workers; continue to provide benefits to spouses after divorce or separation; and provide for early retirement at age 62. The NUL has signed onto the principles of the New Century Alliance for Social Security to set forth goals for reforming Social Security. Fellow signers include the NAACP, Rainbow—PUSH Coalition, National Council of Negro Women, National Council of La Raza, the Children's Defense Fund, and the National Organization for Women.

Currently, Social Security, whose program's formal name, Old Age, Survivors and Disability Insurance (OASDI), replaces more of the wages of workers who had low earnings during their working careers than high wage workers. African Americans, because of continued affects of discrimination are disproportionately among low wage workers.

Social Security provides retirement and other benefits to women, through the earnings of their spouse. This protects women married to low wage workers. In a privatized system, women married to low wage workers would have their benefits split if their spouse remarried. Because the marriages of low wage workers are less stable, privatization would disproportionately affect such women. Low wage workers often have the most physically demanding jobs, and have lower life expectancies. Raising the early retirement age would make it likely that they would not be able to work until retirement, or live long enough to collect Social Security benefits. And, because low wage workers are in more physically demanding jobs, they are more likely to need disability benefits. All plans should be measured against those concerns.

Debating "Social Security" drops the program's formal name, Old Age, Survivors and Disability Insurance. "What is in a name?" Shakespeare asked. The current public debate is about the annuity portion of the program. Great debate. Interesting points. The problem is, the Old Age, Survivors and Disability Insurance program is about more than Old Age. For purposes of clarity, OASD Insurance, as its full name implies, is an insurance program. The tax collected to support the program comes from the Federal Insurance Contribution Act. It can best be described as a life insurance product, with disability and an annuity fully indexed to inflation.

In debating the annuity portion of the program, much has been made about the "pay-as-you-go" nature of Social Security. Oddly, when the system began, planners had great concerns about inadequate growth in the economy, and a fear that the birthrate would not recover from its Depression era low-level, so a growing share of the population would be elderly.[1] Still, the decision was made to grant full retirement benefits to workers as they retired. This ignored that those workers had not participated in the Social Security system long enough to have created the savings justifying their benefits. Less is made about several changes that have taken place since then. Four major changes were the extension of family benefits for survivors, spouses and dependents in 1939, the addition of disability benefits in the 1950's, and then later lowering the age when workers could collect disability benefits, and

[1] Edward D. Berkowitz, Yesterday and Today: History and Social Security Reform, presented at the 11th Annual Conference and Membership Meeting of the National Academy of Social Insurance, Washington, DC, (January 27–28, 1999).

granting early retirement in 1961. Those transformations created an insurance program, from an aid to the elderly program. To make the insurance system work, then, there is a delicate balance among those who will get benefits as retirees, as spouses of retirees, as widows or widowers, as dependent children, and as disabled workers. Changing one component of the system, therefore, has ramifications for that balance. So, balancing the retirement benefit cannot be done without affecting the other components of the program. Almost half the African Americans who receive benefits under the current program receive disability, dependent or survivors' benefits.

As an insurance product, OASD Insurance is very unique because it insures families. The benefits of the program are not just for the worker, but for the worker's dependents and spouse. That makes the program very complex, and difficult to assess, when viewed as only an annuity program for a worker. Calculations of "rates of return" on the program miss that point. When viewed as an insurance program, the "rate of return" calculations for the program look different, for whites and African Americans.[2]

In the real world, income, family structure and life expectancy combine in very complex ways. So, calculating a "rate of return" on Federal Insurance Contribution Act taxes for a hypothesized "typical" worker is difficult since the "typical" worker must be matched along a wide array of characteristics. For instance, taking the median income for workers and creating a hypothetical worker, with assumed family structure and life expectancy, and the likelihood of becoming disabled, may be giving family characteristics, life expectancy or chances of disability that would not be common for workers of that income. Even if the median worker along all the dimensions was characterized, movement away from the median in one direction, like family structure, could be dramatically different than movement away from the median in another direction, like life expectancy. This is because the median of each individual characteristic, like income and life expectancy, is not the same as the median for the combined characteristics of income and life expectancy.

The broad based support for the program comes from the many ways it touches the lives of American families. For some families, it is in the receipt of disability benefits. For some it is in the receipt of dependent survivor benefits. For some it is in the receipt of old age retirement benefits. For each family, a different need is met. A program which separated the treatment of retirement from the family insurance portion of the program would not have such a universal family focus. A program that separated the individual worker, and placed the risks of a decent retirement lifestyle on the individual and so removed the assurance of the program because of its insurance nature, would not have such a universal family focus. It would move the intergenerational transfer of funds to support the elderly from a socially secured level, to individuals. And, so would put greater burdens on low wage earners, because their parents are more likely to also have had low earnings.

The Americans Discuss Social Security Project has found that Americans overwhelmingly value most of the social insurance aspects of the program, specifically disability and survivor benefits.[3] So the National Urban League's concerns are the ones Americans, in general, have.

For African American families, the OASD Insurance program works. An analysis of benefits paid relative to taxes paid shows that, on net, African American families have received more benefits than were paid in taxes.[4] For an insurance program, that is unique. In the private market, insurance premiums exceed benefit disbursements.

Many aspects of the OASD Insurance program would be unavailable to African American families in the private market. Disability insurance would be difficult for many African American workers to get, or afford. And, differences to access in life insurance between whites and African Americans probably reflects a marketing decision of life insurance companies to avoid the higher mortality rates for African Americans. But, most notably, three aspects of the OASD Insurance product are unique. One is the progressive nature of the benefit structure, which compensates for the lower earnings of African American workers. The benefit structure is progressive because it lets low wage earners recover a higher amount of their earnings, and because the earnings formula ignores the lowest years of earnings, which for

[2] See Dean Baker, The Full Returns from Social Security, A Century Foundation/Economic Policy Institute Report, Century Foundation, 1998.

[3] Americans Discuss Social Security, Citizen Voices on the Future of Social Security: What We're Learning and How We're Learning It, (November 25, 1998).

[4] See David R. Leimer, "Historical Redistribution Under the Social Security Disability Insurance Program," Social Security Bulletin, Vol. 61 (Number 3, 1998): 3–19.

African American workers can be greatly affected by a much higher relative unemployment rate, especially for young workers.

Another is the indexation of benefits, to prevent the effects of inflation eroding the purchasing power of benefits.[5] This has been extremely important as the purchasing power of the earnings of African American men, in particular, have seen a dramatic fall in the last twenty years. So, unindexed disability and retirement benefits tied to their earnings would have fallen more than the indexed benefits.

Finally, again, is the extension of benefits to cover dependents. To equally provide for additional dependents would require a higher premium in the private market. Yet, OASD Insurance automatically covers the expansion of families.

Thus, calculations that suggest a low rate of return on Federal Insurance Contribution Act taxes for African Americans, miss the complex structure of the program as it plays out for real African American families.[6] They also tend to misrepresent the nature of the lower life expectancy of the African American population. (See the attached Figures 1 and 2). Differences in mortality between whites and African Americans, and hence life expectancy, are greatest for African Americans in their twenties and thirties. That set of workers has low earnings, and would accumulate very little value in individual accounts. Maintaining the insurance and family based benefit structure of the OASD Insurance program is vital for the fairness of the program to them, and so to African Americans.

The National Urban League would look with great alarm on attempts to alter the insurance nature of the program by shifting to individual retirement accounts. We would be greatly concerned about the implied change in the philosophy of the program that would signal. We believe that the broad support of the program comes from its family orientation. Individual accounts would shift the focus from families to individuals. It is unlikely, given that change in philosophy that the insurance portion of the program could stand alone. To date, the proposals to do so, have proposed reductions in disability and survivors benefits that would not be acceptable to us, because such cuts would knock the current program out of balance for African American families.[7]

The National Urban League would also be concerned that individual accounts could not produce the benefits of the current system. A more realistic modeling of the switch to individual accounts, done by the Employee Benefits Research Institute, found individual accounts would lower benefits for most workers, but especially for low-income Americans.[8] A shift from the current system—which is a defined benefit program, like many private pension plans—to a defined contribution plan—like a 401(k), would be costly. The shift would require the next generation to pay for their own retirement and continue to support the current program. Proposals to take even as little as 2 percent out of the current structure to be set aside for individual retirement accounts would increase the gap in revenues needed to maintain the current program.

Another issue is the soundness of the program that will be tested when the number of retirees, compared to the number of workers, shifts as the baby boom generation begins to retire. The number of workers per retiree is a way to view the demographic changes of the next century. But, another view is the number of workers to the number of non-workers. From that perspective, the next century will be less a challenge than the 1960's. Why? Because in the 1960's the number of children and retirees were greater per worker than they will be in the beginning of the next century. The smaller number of children is a greater factor than the greater number of retirees.

But the fear of the baby boom generation retirement has served to mislead debating the size of the problem. Privatization of benefits with individual accounts is not necessary to save Social Security. The retirement benefits portion of the program is the most successful anti-poverty program the government has ever run. Little wonder. It is a massive transfer of income to low income households. So, there is an ideological string that will attack the transfer, and want to make the program more closely tied to an individual worker's own earnings. We hope this program is

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[5] See for example, Kelvin R. Utendorf, "Recent Changes in Earnings Distributions in the United States," Social Security Bulletin, Vol. 61 (Number 2, 1998): 12–25.

[6] For a discussion of fallacies in some of these calculations, see Kilolo Kijakazi, African Americans, Hispanic Americans, and Social Security: The Shortcomings of the Heritage Foundation Reports, Center on Budget and Policy Priorities, (Revised October 8, 1998).

[7] See Kathy Larin and Robert Greenstein, Social Security Plans that Reduce Social Security Retirement Benefits Substantially are likely to Cut Disability and Survivors Benefits as Well, Center on Budget and Policy Priorities, (December 15, 1998).

[8] Kelly Olsen, Jack VanDerhei, Dallas L. Salisbury, Martin R. Holmer, How Do Individual Accounts Stack Up? An Evaluation Using the EBRI–SSASIM2 Policy Simulation Model, Employee Benefit Research Institute Report No. 195 (March 1998).

not the place to fight an ideological war. The well being of the elderly should be beyond ideology, and risking a proven approach to lower poverty for senior Americans. The Washington Post has concluded that privatization, "has great ideological appeal to those who would reduce the role of government in political life. But a successful bedrock program central to the well-being and otherwise vulnerable share of the population is the wrong place to conduct an ideological trophy hunt."

What is the size of the problem? Law requires the Social Security Board of Trustees to project the solvency of the Social Security system 75 years out. The 1998 Board of Trustees report suggests that in the year 2019, if the benefit and tax structure for OASDI do not change, then to maintain current benefits, the system will need additional revenue. For a while, the additional revenue will come from the Social Security Trust Fund. Then in 2032, the trust fund will be depleted, and the program will need additional revenue, or benefits will need to be reduced. The system will not be "broke." The projected revenue stream in 2032 will be able to meet $0.75 per $1.00 of current benefit levels. So, the debate is how to resolve the $0.25 gap.

First, it is important to understand that the projected revenue stream assumes that the economy will grow at a 1.5 percent rate over the next 75 years. In the past 75 years, the economy has grown at a 3.5 percent rate. In the past 20 years, the economy has slowed, but has still managed to grow at a 2.5 percent rate. The pessimistic view of a 1.5 percent growth rate is based on projections of slow productivity growth and a low growth rate in population. For the ten year period that the Congressional Budget Office and the Social Security trustees forecast of the trust fund overlap, the CBO estimates the trust fund will be over $300 billion greater than the Trustees forecast.

Using a more optimistic view of economic growth, the Social Security trustees found no problem in 2032. Business Week has noted that, "America doesn't need to kill Social Security to save it. It just has to grow fast enough to save the boomers." As Hugh Price explained in his comments before the New Century Alliance for Social Security press conference December 3, 1998 a faster growth rate could be achieved by making investments in our children—the workers of our future.

Second, it is important to understand that the Trust fund running out is not the same as the insolvency of Social Security. The Trust fund is created by the current FICA tax being greater than the current benefits paid by Social Security. The Trust fund was created by Congress to provide a cushion for when the baby boom would begin to retire. It did not always exist, and is not a major funding source for the program now. In 2032 we will simply return to the pay-as-you-go system that marked most of the program's history. To meet the shortfall that the Social Security Trustees project, we would need to raise FICA taxes from their current 6.2 percent level to 7.3 percent. So, the debate is whether to do that, or lower benefits, or some combination of the two.

Thanks to the down payment on the problem that President Clinton has proposed, drastic changes are not necessary given the size of the problem. Many minor changes can be made to the program to maintain its current structure, and be fair to future workers. For instance, without increasing the Federal Insurance Contribution Act (FICA) tax rate, but extending the range of income taxed to reflect changes in the wage distribution would close about one-fourth of the gap between projected benefits and revenues. Currently, the FICA tax is collected on the first $68,400 of income. That affects about 85 percent of wage income. The more typical historic level has been to collect taxes on 90 percent of wage income. So, increasing the cap on FICA taxable income to restore that historical level could be done to restore revenue.

The National Urban League would have great concern about increasing the age for early retirement and similarly for retirement with full benefits. Commissioner Kenneth Apfel testified before your Subcommittee on Social Security in February, and raised some of the concerns we have.[9] Early retirement at age 62 gives African Americans, with lower life expectancy, a program that is more fair. Part of the concern is the issue of health for retirees. The National Urban League has an additional concern about employability. We have 24 affiliates that operate the Seniors in Community Service Program for the Department of Labor. The National Urban League has operated this program for twenty years. In 1997–1998 we served 3,203 participants, 89 percent of the participants were minorities, 74 percent women, and 89 percent were below the poverty level. We were able to transition 595 participants into unsubsidized employment, which achieved 138 percent of the 20 percent Department of Labor annual placement goal. So, we are one of the more successful

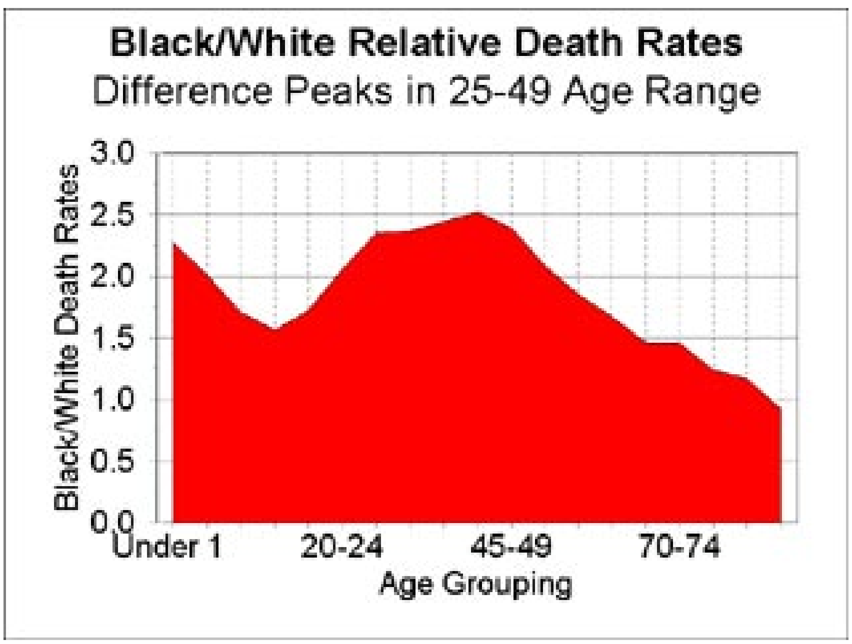
[9] Kenneth S. Apfel, Commissioner, Social Security Administrator, Testimony Before U.S. House of Representatives Ways and Means Subcommittee on Social Security, 105th Congress, 2nd Session, February 26, 1998.

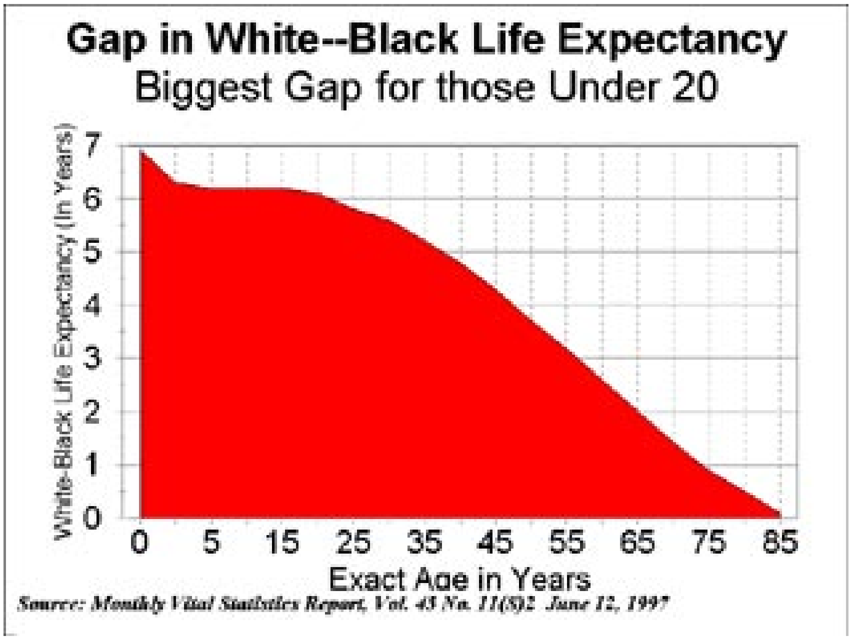
partners for the Department of Labor in providing services. The participants averaged $6.76 an hour, with the highest hourly wage being $8.33. Half the unsubsidized placements were in the nonprofit sector, while 36 percent were in the private for-profit sector.

The data from our program strongly suggest the difficulty that low-income seniors face in the labor market. Even though our program served 49 percent more seniors than the number of established enrollment positions, the need for our services was far greater. So, despite our concerted efforts as a partner with the Department of Labor, we have observed first-hand the difficulty low-income seniors have in finding employment.

Other solutions are being discussed. Serious consideration should be given to allowing the Trust fund to diversify and make investments in stocks as well as in U.S. Treasury notes. Currently, by law, the Trust fund buys U.S. Treasury notes. Because they are very secure investments, U.S. Treasury notes have a low rate of return. Stocks have more risk, and so investments in stocks have always had a higher rate of return. The higher rate of return compensates investors for the risk involved. Most state retirement plans have a diversified portfolio that includes safe government securities, and riskier stock investments. Of course details need to be settled around this change.

The issues facing Social Security, face all Americans. The National Urban League hopes that solutions can consider all Americans. Americans who are disabled, Americans who are spouses of retired workers, Americans who are dependents of workers, and Americans who survive workers all need to be considered. We think Americans value most the safety net of Social Security. Changing the philosophy of the program, would remove the moral underpinnings that Americans value.





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Chairman SHAW. Thank you. Help me once more.

Ms. KIJAKAZI. Kilolo Kijakazi. It's easier when you say it slowly.

Chairman SHAW. It's a very pretty name.

Ms. KIJAKAZI. Well, thank you.

STATEMENT OF KILOLO KIJAKAZI, PH.D., SENIOR POLICY ANALYST, CENTER ON BUDGET AND POLICY PRIORITIES

Ms. KIJAKAZI. Chairman Shaw and Members of the Subcommittee, thank you for inviting me to testify. I am, as I said, Kilolo Kijakazi, a senior policy analyst with the Center on Budget and Policy Priorities.

My testimony will focus on the importance of Social Security to African-Americans, the limitations of some proposals to reform Social Security using individual accounts, and an alternative approach that would maintain the guaranteed benefit provided by Social Security.

Social Security has been one of the country's most successful programs, as pointed out by Chairman Shaw. The program is of particular importance to African-Americans. Elderly African-American households rely on Social Security for 77 percent of their income, compared to 60 percent for elderly white households.

This is not surprising given the lower rates of pension coverage for African-Americans, as Mr. Spriggs just pointed out. Pension income makes up 46 percent of income for elderly white households, but only 35 percent for elderly African-Americans.

Additionally, African-Americans are disproportionately represented among low-wage workers, which means that we have fewer resources to set aside for retirement saving. This places greater weight on Social Security as a reliable, guaranteed source of income.

The arguments have been made by the Heritage Foundation and other organizations that Social Security provides a lower rate of return to African-Americans due to our shorter life expectancy. This reasoning is faulty because it overlooks the protections that Social Security provides for African-Americans and low-wage workers.

Three aspects of Social Security help to compensate African-Americans for our higher mortality rate. First, since African-Americans make up a disproportionate share of low-wage workers, we gain from the progressive benefit formula.

Second, early retirement is an option that is elected by two-thirds of all workers, including African-Americans. Due to our shorter life expectancy, receiving benefits earlier and for a longer period of time increases the total benefits we receive and raises the rate of return that we get from Social Security.

And third, Social Security is a comprehensive insurance program. African-Americans benefit disproportionately from the disability and survivors insurance components of the program.

Some studies, including the Heritage Foundation's research, have attempted to estimate Social Security's rate of return for African-Americans. The Social Security Administration's Office of the Chief Actuary has found that their methodology was faulty. Consequently, their estimates were wrong.

Robert Meyers, the former Chief Actuary for Social Security, also criticized such attempts to estimate rates of return without having sufficient information. One study, by Duggan, Gillingham and Greenlees, who were researchers at the Treasury Department, did have access to the necessary data. These researchers found that African-Americans have a slightly higher rate of return than the general population.

A second study by Dean Leimer at the Social Security Administration looked specifically at the disability insurance component of Social Security and found that African-Americans had a substantially higher rate of return than whites.

Although Social Security has been successful, it is clear that there is a need for making some changes in the program, given the demographic changes ahead. However, some proposals would be particularly disadvantageous for African-Americans. These include plans to privatize Social Security by diverting payroll taxes from the Social Security Trust Fund to individual accounts. Proponents of these plans often fail to factor in privatization costs. First, the unfunded liability, that is, the financial obligation to current and near retirees, must be paid whether we retain the existing system or privatize it. This is the transition cost. When the Employee Benefit Research Institute factored in the transition cost, they found that young, low-wage workers are likely to face lower rates of return under individual accounts than under any option they examined to restore solvency to Social Security without individual accounts. I think this addresses Mr. Portman's question.

Second, administrative costs will also reduce the rate of return for individual accounts. Henry Aaron of the Brookings Institution and Peter Diamond of MIT have estimated that the administrative costs for IRA-type accounts would eat up 20 percent of savings of a workers over a 40-year work life.

Additionally, the cost for workers to annuitize their savings would consume another 15 to 20 percent of their accumulated savings.

And finally, low-wage workers are not as likely to receive high rates of return from individual accounts. They are more likely to invest conservatively—which is logical since they have less financial capacity to sustain losses. These workers also have less investment experience, and fewer resources with which to purchase investment advice.

An alternative approach has been offered by President Clinton. He has proposed to restore solvency to Social Security thereby ensuring workers would receive a defined, guaranteed benefit. In addition to restoring the defined benefit, he proposed to add USA accounts. These accounts would be funded with 12 percent of the unified budget surplus and would not divert payroll taxes from the trust fund.

Furthermore, these accounts would be progressive in two ways. Equal amounts would be contributed to accounts for each worker, thus contributions would make up a larger percentage of income for low-wage workers. Additionally, a progressive match would be provided to workers who contribute some of their own savings to these accounts. This proposal would leave the basic Social Security system intact. And since Social Security has played such a vital role in the economic well-being of African-Americans, this is an essential factor in Social Security reform.

[The prepared statement follows:]

Statement of Kilolo Kijakazi, Ph.D., Senior Policy Analyst, Center on Budget Policy Priorities

Chairman Shaw and members of the subcommittee, thank you for inviting me to testify today. I am Kilolo Kijakazi, a senior policy analyst at the Center on Budget and Policy Priorities. My testimony will focus on the importance of Social Security to African Americans, the limitations of some proposals to reform Social Security using individual accounts and an alternative approach that would maintain the guaranteed benefit provided by Social Security.

SOCIAL SECURITY'S SUCCESS

Social Security has been one of the country's most successful social programs. It is largely responsible for the dramatic reduction in poverty among elderly people. Half of the population aged 65 and older would be poor if not for Social Security and other government programs. Social Security alone lifted over 11 million seniors out of poverty in 1997, reducing the elderly poverty rate from about 49 percent to about 12 percent. Additionally, Social Security has become more effective in reducing poverty over time. In 1970, Social Security reduced the poverty rate among the elderly from about 50 percent to 17 percent, compared to 12 percent today.

Social Security payments provide the majority of the income of poor and near poor elders. It is the major source of income for 66 percent of beneficiaries age 65 or older and it contributes 90 percent or more of income for about 33 percent of these individuals.

THE IMPORTANCE OF SOCIAL SECURITY TO AFRICAN AMERICANS

Social Security is particularly important to African Americans. Elderly African Americans rely on Social Security benefits more than white elders rely on the program. Social Security benefits make up 77 percent of the income received by elderly African American households, compared to 60 percent of elderly white households. This is not surprising given the lower rates of pension coverage for African American. Among households with workers age 30–50, only 48 percent of African Americans have pension coverage while 61 percent of whites are covered. Pension income makes up 46 percent of total income for elderly white households, but only 35 percent of total income for elderly African American households. Moreover, African Americans are disproportionately represented among low-wage workers. It is, therefore, more difficult to set aside savings for retirement to supplement Social Security. While Social Security is intended to be one leg of a "three-legged stool" for retirement income, the lack of pension coverage and limited resources for savings place greater weight on Social Security as a reliable source of income for many African Americans.

PROTECTIONS OF SOCIAL SECURITY

The argument has been made that Social Security provides a lower rate of return to African Americans because this community has a lower life expectancy than the general population. Based on this premise, an African American worker would contribute payroll taxes, but would not live long enough to receive Social Security benefits sufficient to achieve the same rate of return as non-African American beneficiaries. This reasoning is faulty, however, as it overlooks important protections Social Security provides for African-American and low-wage workers including disability and survivors insurance.

The design of the Social Security system helps to compensate African Americans for their shorter life expectancy. There are three aspects of the program that provide such protection. First, Social Security's benefit formula is progressive. Benefits replace a larger percentage of pre-retirement earnings for low-wage workers than high-wage workers. Since African Americans are disproportionately represented among low-wage earners, they gain from this formula.

The second feature is the option for early retirement. The Social Security System allows workers either to retire with full benefits at a given age, currently 65, or to retire early with reduced benefits. A worker can take early retirement at age 62. Workers who retire at 62 contribute payroll taxes for three fewer years. They also begin receiving benefits three years earlier, with monthly benefits reduced to compensate for the increased number of years during which they will receive benefits.

The reduction in the monthly benefit amount for those who retire early is based on actuarial tables and is intended to make the amount of benefits received from age 62 to the point of death equivalent, on average, to the amount of benefits retirees would receive if they waited until the "normal retirement age" to retire. Over the population as a whole, the Social Security early retirement option is close to a wash—the lower monthly benefits paid are designed to offset the increased number of years for which benefits will be received.

The story is different, however, for African Americans. Given the shorter life span for African Americans, the benefits these early retirees receive from age 62 to the end of their lives exceed the benefits they would receive, as a group, if they waited until 65 to retire. Starting to receive benefits several years earlier increases the total benefits they receive and raises their average rate of return.

Two-thirds of all workers, including African Americans retire early. Thus, most African-American retirees are compensated for their shorter life span by this aspect of Social Security.

The third component of Social Security that mitigates the impact of higher mortality among African Americans is the comprehensive nature of the program. Social Security is not solely a retirement program, but also an insurance system that protects against risks that are unforseen or for which workers are not sufficiently prepared. In addition to benefits for retired workers, Social Security provides benefits to the worker's spouse and dependents when the worker retires or becomes disabled, as well as survivors benefits if the worker dies. The divorced spouse of the retired or deceased worker also is generally entitled to benefits.

African Americans benefit disproportionately from the disability and survivors components of Social Security. While African Americans account for 11 percent of the civilian labor force, they comprise 18 percent of the workers receiving Social Security disability benefits in 1996. When a worker becomes disabled, the worker's dependents also become eligible for Social Security benefits. African Americans made up 23 percent of children and 15 percent of the spouses who received Social Security benefits in 1996 because workers in their families were disabled.

As a result of the above-average mortality rates among African Americans, the African-American community benefits disproportionately from the feature of Social Security that provides benefits to non-elderly survivors. Although African-American children comprise about 16 percent of all children in the United States, they made up 24 percent of the children receiving survivors benefits in 1996. African Americans also accounted for 21 percent of the spouses with children who received survivors benefits. Benefits for non-aged survivors are one of the aspects of Social Security most favorable to African-American workers.

Some studies have attempted to estimate Social Security's rate of return for African Americans. The Social Security Administration's (SSA) Office of the Chief Actuary has assessed some of these estimates, such as those used by Heritage, as well as the methodology for reaching the estimates. The actuaries found that the methodology was inaccurate; consequently the estimates were wrong. Furthermore, Robert Myers, a former Chief Actuary of SSA, heavily criticized such attempts to calculate rates of return particularly those by Heritage, without sufficient information.

Most of these studies faced a major limitation. They did not have access to databases on actual earnings records of workers and benefits of retirees, the Continuous Work History database. This information is confidential and is not released to the public so that the privacy of workers and beneficiaries will be protected. These data have only been available to Treasury and SSA. One study that did not face this limitation was conducted by employees of the Treasury Department (Duggan, Gillingham, and Greenlees). These researchers did have access to the Continuous Work History database. Their research showed that African Americans had a slightly higher rate of return from Social Security retirees and survivors than the general population. A second study by the Social Security Administration also used this database and looked specifically at disability insurance. It shows that African Americans received substantially more benefits from Social Security Disability Insurance in relation to the taxes they have paid than whites do. Thus, despite the shorter life span of African Americans, aspects of the programs such as the progressive benefit, early retirement and comprehensive insurance, offset the effects of higher mortality rates for this community.

THE NEED FOR REFORM

Although the Social Security System has clearly served as an important source of income for the general population, including African Americans, demographic changes necessitate reforms in the program to maintain solvency. The baby-boom generation is aging and will begin retiring in large numbers after 2010. By 2025, most of this group will be 65 or older.

Moreover, rising life expectancy will further increase the number and proportion of the population that is elderly. The Social Security actuaries' projections, reported by the Social Security trustees, show the number of people age 65 and older will nearly double from 34 million in 1995 to 61 million in 2025. During that period, the proportion of the total population that is elderly will grow from 12.5 percent to 18.2 percent. There also will be a decline in the rate of growth of the working-age population. As a result of these various changes, the ratio of workers to Social Security beneficiaries will decrease from just over three-to-one today to two-to-one in 2030, and remain at approximately this level through 2075, the last year of the actuaries' projections. At that point, the elderly will comprise 22.7 percent of the total population.

Social Security payroll tax revenues currently exceed benefit payments and the trust funds are accumulating assets. The demographic changes that lie ahead, however, will result in substantial increases in benefit payments in coming decades and create an actuarial imbalance in the program over the long-term. The actuaries project that the assets in the trust funds will be exhausted by 2032.

After 2032, the trust funds will be dependent entirely on payroll tax collections for income. From that time on, Social Security will be insolvent because it will not have sufficient annual income to make the full benefit payments to which its beneficiaries are entitled by law. This does not mean Social Security will collapse at that time and have no funds to pay any benefits; to the contrary, the problem is that after 2032, incoming payroll taxes are projected to be sufficient to cover about 75 percent of the benefit payments, rather than 100 percent of these costs. Policymakers need to make policy changes that eliminate this shortfall.

DRAWBACKS OF SOME INDIVIDUAL ACCOUNT PROPOSALS

Some proposals to reform Social Security would be particularly disadvantageous to African Americans. Proposals to fully or partially privatize Social Security by diverting payroll taxes from the Social Security trust funds to individual accounts would have a detrimental impact on low-wage workers and African Americans.

How is it possible for advocates of individual accounts that replace Social Security benefits to claim that their proposals will benefit African Americans and low-wage workers? The answer is proponents of these accounts often fail to factor in the costs and risk of such individual accounts when determining the rate of return for the accounts. There are three such types of costs—transition costs, the administrative costs, and the cost to covert accounts to annuities.

If retirement benefits are privatized, the payroll taxes that are currently used to finance Social Security retirement benefits will instead be deposited in individual accounts. That will create a financing gap—funds will be needed to fulfill the government's obligation to pay Social Security benefits to current retirees and those nearing retirement. Robert Reischauer, a senior fellow at the Brookings Institution, addressed this point in his statement at the White House Forum on Social Security in New Mexico, July 27, 1998. "Whether we retain the existing system or privatize it, this unfunded liability will have to be met unless we renege on the benefits promised to today's elderly and near elderly. Dealing with the unfunded liability inescapably will reduce the returns workers can expect on their contributions."

Under a privatized system that diverts all payroll taxes into individual accounts, workers would have to pay a new tax to continue financing the Social Security benefits of current and soon-to-be retirees. As senior researcher Paul Yakoboski of the Employee Benefit Research Institute recently testified, "Because the current Social Security system is largely pay-as-you-go, most of what workers pay into the system funds today's benefits. . . . [O]n top of paying current benefits, workers moving to a privatized system would have to pay 'twice'—for the benefits going to today's beneficiaries and again to their own [personal] accounts." For this reason, the General Accounting Office has noted that if Social Security retirement benefits were privatized, "the [payroll] contributions needed to fund both current and future retirement liabilities would clearly be higher than those currently collected."

A study conducted by the Employee Benefit Research Institute incorporated transition costs into its calculations. It found that for workers who are 21 today and receive low wages, the rate of return would be lower under the individual accounts options it examined than under all options it examined to restore long-term balance to Social Security without individual accounts.

Administrative costs further reduce the rate of return for individual accounts. Accounts that are designed like IRA accounts will result in significant administrative costs and management fees, which would be paid out of the proceeds of the accounts and consequently reduce the amounts available in those accounts to pay retirement benefits. Moreover, additional costs are incurred when the funds in these accounts are converted to lifetime annuities upon retirement.

Based on data on IRA accounts, two eminent Social Security experts—Henry Aaron of the Brookings Institution and Peter Diamond of M.I.T.—have estimated that the administrative costs for retirement accounts like IRAs would consume 20 percent of the amounts that otherwise would be available in these accounts to pay retirement benefits. They note that a one percent annual charge on funds in such accounts eats up, over a 40-year work career, 20 percent of the funds in the accounts. The 1994–1996 Advisory Council on Social Security estimated an annual charge of one percent on the assets in privately managed individual accounts.

Furthermore, recent financial data indicate that a one percent annual charge is a conservative estimate. In 1997, the average annual charge on stock mutual funds was 1.2 percent of the amounts invested in those funds. In addition, Diamond has noted that administrative and management costs consume approximately 20 percent of the amounts in individual accounts in Chile's privatized retirement system and more than 20 percent of the funds in privatized retirement accounts in Great Britain and Argentina.

Some of these costs are fixed-dollar expenses that do not vary with the size of an account. As a result, such costs would generally consume a larger percentage of the amounts in smaller-than-average accounts (and a smaller percentage of the amounts in large accounts). This suggests these costs would, on average, consume more than 20 percent of the funds in the accounts of lower-wage workers. That is of particular significance to African-Americans since, as a group, they receive lower-than-average wages and would consequently have smaller-than-average accounts.

To these costs must be added the costs of converting an individual account to an annuity upon retirement. The leading research on this matter indicates that an additional 15 percent to 20 percent of the value of an individual account is consumed by the costs that private firms charge for converting accounts to annuities. The General Accounting Office recently noted that "While individual annuities are available, they can be costly especially relative to annuities provided through Social Security."

Taking all of these costs into account—both administrative and management fees and the costs of converting accounts to annuities—Aaron estimates that at least 30 percent and as much as 50 percent of the amounts amassed in individual accounts similar to IRAs would be consumed by these costs rather than being available to provide retirement income. (While the administrative cost would be lower for accounts centrally managed similar to the federal employees Thrift Savings Plan, the cost would still be significantly higher than the administrative cost for Social Security.)

In addition to the costs of these individual accounts, there are some risks. Retirees who are particularly lucky or wise in their investments could receive retirement income from individual accounts that more than offsets their loss of Social Security benefits. But retirees who are less lucky or wise, including those who retire and convert their account to a lifetime annuity in a year the stock market is down, would likely face large reductions in the income they have to live on in their declining years.

A recent GAO report takes note of these issues. "There is a much greater risk for significant deterioration of an individual's 'nest egg' under a system of individual accounts," the GAO wrote. "Not only would individuals bear the risk that market returns would fall overall but also that their own investments would perform poorly even if the market, as a whole, did well.[1]

This is a concern for workers in general—surveys have found Americans are not very knowledgeable about financial markets—and a particular concern for lower-wage workers, who generally would not be able to afford as good investment advice as individuals at higher income levels. Moreover, lower-income groups have less investment experience and would be more likely to invest in an overly conservative manner because they could not afford to expose the funds in their accounts to much risk. African Americans and Hispanic Americans make up disproportionate shares of the low-income population. As a result, they would be likely to receive a somewhat lower-than-average return on amounts invested even while, as explained above, they would likely pay an above-average percentage of their holdings in fees.

An Alternative Approach

There is an alternative to plans that would fund individual accounts by diverting payroll taxes from the Social Security trust funds. In his 1999 State of the Union address, President Clinton proposed to commit 12 percent of the unified budget surplus to the creation of USA Accounts.

A key difference between the previously discussed accounts and the President's proposals is that the first step taken would be to reestablish solvency within the defined benefit portion of the Social Security System, without redirecting any of the payroll revenue to USA accounts. The President's plan would preserve the guaranteed benefit that is the cornerstone of the Social Security System and would not divert any revenue from the trust funds.

Furthermore, the USA accounts are designed to be progressive in two ways. First the government would contribute the same amount of money to each worker's account. This means the contribution will represent a higher percentage of income for low-wage earners than for high wage earners. Second, under this proposal, the government would also provide progressive matching contributions to workers who add their own savings to their accounts. For example, a low-wage worker might receive a dollar match for each dollar he or she contributes to the account while an average-wage worker might receive a match of 50 cents for each dollar he or she contributes.

This proposal would leave intact the basic Social Security System that has played such a vital role in the economic well-being of African Americans. At the same time, it would encourage savings using a design that targets resources to workers who would benefit the most from a boost in their retirement income.

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Chairman SHAW. Mr. Rodríguez.

STATEMENT OF ERIC RODRIGUEZ, SENIOR POLICY ANALYST, NATIONAL COUNCIL OF LA RAZA

Mr. RODRIGUEZ. Thank you, Mr. Chairman. Mr. Chairman and Members of the Subcommittee, my name is Eric Rodríguez. I'm a senior policy analyst at the National Council of La Raza, the Nation's largest constituency-based Hispanic organization.

[1] General Accounting Office, Social Security: Different approaches for Addressing Program Solutions, July 1998, p. 6.

I would like to thank the Subcommittee for allowing me the opportunity to participate in this hearing and contribute to this discussion.

Let me preface my oral statement by saying that this is a new issue for NCLR, and we have undergone a rigorous process to get at the substance of the issue for Hispanics. Our work on retirement issues and Social Security reform is not and has never been ideologically driven.

We have participated in roundtable discussions with Hispanic leaders, have conducted a townhall meeting at our annual conference, and have participated in forums with leading policymakers. This testimony is the result of this lengthy process.

Why is it important to consider Hispanics in this discussion? Because Social Security reform is not just a retirement issue, but also a work force issue. Currently, 10 percent of U.S. workers are Hispanic. Hispanics are projected to make up more than 17 percent of the U.S. labor force by 2020. Hispanics tend to work in low-paying jobs with no benefits, like pension coverage. Hispanics typically have low earnings and little disposable income to save and invest for their own retirement. And Hispanics tend to rely heavily on Social Security for retirement support.

Therefore, for Hispanics, the system has to be there. Moreover, Hispanics need to be considered in this discussion because of demographic projections that tell us that Latinos will play a critically important role in supporting and preserving the Social Security Program.

Consequently, the effectiveness of any long-term Social Security solution may hinge on how it impacts Hispanic workers.

So what about Latinos and the Social Security system? It is important to point out that we believe Social Security benefits Hispanics more than any other group of Americans. This is largely because the Hispanic community's economic profile closely resembles the overall U.S. population during the thirties, when Social Security was created. In general, many Hispanics earn low wages, experience higher than average unemployment, do not save and invest for retirement, have limited access to quality health care and pension coverage, and experience disproportionate poverty among their elderly.

The Social Security system is designed to progressively benefit low-wage earners, so Latinos fare well under the current structure. Hispanic retirees maintain higher than average rates of return on payroll tax contributions and better than average replacement rates on annual earnings. As a result, the guaranteed benefit and the social insurance character of the current Social Security system significantly helps Latinos.

What are some of the concerns we have with Social Security reform initiatives?

Overall, we agree that it is desirable for lawmakers to bring the Social Security system into long-term fiscal balance. However, we have some serious concerns with the direction of several prominent provisions.

Specifically, we believe that a payroll tax increase will greatly affect Hispanic workers already overburdened by the current tax rate and that benefit cuts could significantly increase poverty among retirees, especially those who were formerly low-wage workers and who solely rely on Social Security as a main source of retirement income.

Furthermore, we believe the benefits of transforming the Social Security system into a more privatized one are vastly overstated, and we have serious concerns that such a plan would undermine the social insurance character of the system, erode the guaranteed benefit, and impose severe costs on low-wage workers, like Hispanics, over the long run.

Therefore, we are inclined to oppose any reform proposals that feature any of these three elements.

So what are the key elements of reform that are most promising for Latinos?

Overall, we understand that the final Social Security reform package may contain measures that directly reduce benefits and increase revenues into the system. NCLR will support only the most progressive means of bringing the system into long-term fiscal balance.

Of utmost importance to Latinos is maintaining the social insurance character of the current system. Therefore, the best Social Security reform package for Latinos would retain the equity and progressivity of the current system and maintain a guaranteed benefit upon retirement.

Nevertheless, NCLR supports the goals of improving the economic status of elderly retirees, and increasing the retirement savings rates of Americans. However, we are not convinced that a dramatic change in the Social Security Program is the only, much less the most appropriate course, to achieve these goals.

From NCLR's perspective, the most successful Social Security reform efforts should include a modest plan that brings the Security System into long-term balance and separate proposals that reduce poverty levels among elderly retirees, increase the retirement savings rate of Hispanic and other low-income Americans, and increase the productivity of Latino and other workers.

Such steps are critical not just to ensure a decent source of retirement income for Hispanics, but also to sustain the long-term economic growth of the Nation as a whole.

Bearing this in mind, we applaud the President—President Clinton's proposal to use a large portion of the projected Federal budget surpluses to preserve Social Security, while investing a modest portion in programs designed to promote the future productivity of the work force. We believe it is an important first step and should go a long way toward moderating the potentially harmful economic effects of bringing the Social Security system into long-term fiscal balance.

In addition, while we have some questions regarding the details of his plan, we support the general thrust of President Clinton's proposal to create Universal Savings Accounts, to increase the personal savings among Americans.

As the Nation's demographics change, the Latino population will be an increasingly significant driving force behind America's social, economic and public policy agendas.

With this in mind, NCLR appreciates the opportunity to present our views and strongly encourages Congress to consider and include the perspectives and concerns of the 30,000,000 Hispanic-Americans in the unfolding national debate.

We also welcome you to call on NCLR to provide additional information about the economic well-being of Latino workers and future retirees.

Thank you.

[The prepared statement follows:]

Statement of Eric Rodríguez, Senior Policy Analyst, National Council of La Raza

I. INTRODUCTION

NCLR, the largest constituency-based national Hispanic organization, exists to improve life opportunities for the more than 30 million Americans of Hispanic descent. NCLR acts as an umbrella for almost 230 affiliated Hispanic community-based organizations which together serve 37 states, Puerto Rico, and the District of Columbia, and reach more than three million Hispanics annually through a range of services. NCLR appreciates the opportunity to provide for the record this statement of Latino perspective on Social Security reform.

Given that Hispanics are a growing segment of the total U.S. population and an increasing proportion of the total U.S. elderly and working-age populations, they are likely to play a pivotal role in the nation's economic future. For example, in 1990, Hispanics constituted 8% of the total U.S. workforce, compared to 78% for Whites and 10% for Blacks. However, by 2010, 2020, and 2030, Latinos are projected to account for 13.2%, 15.2%, and 17.2%, respectively, of all U.S. workers. Moreover, between 1997 and 2007, the Hispanic elderly population is predicted to increase 50.2%, and from 1997 to 2020 the number of Hispanics 65 years of age and over is projected nearly to double (an increase of 185.1%).

Notwithstanding this, Latinos have not been fully included in policy discussions related to Social Security, pension coverage, and retirement savings—a dialogue that has sharply intensified over the last two years. Without complete information on, and consideration of, Hispanics and Social Security, the likelihood of policymakers achieving a credible and effective long-term Social Security solution is seriously impaired. For this reason the following statement presents socio-demographic trend data that underscore the importance of the Social Security system for Hispanic retirees and highlight the critical role that Hispanics will play in preserving the nation's pension system. In addition, this statement outlines key public policy areas with regard to Social Security reform and Latinos, and examines specific Social Security reform initiatives, providing a much-needed Hispanic perspective on the relevant reform issues. Finally, the statement offers recommendations on the Social Security reform strategies that are the most promising, and least harmful, for Latinos.

As a point of clarification, the terms "Hispanic" and "Latino" are used interchangeably throughout this statement. In addition, all data presented below are for the Hispanic population in the 50 states, and do not reflect the status of Puerto Rico Island residents.

II. THE SOCIAL SECURITY SYSTEM AND HISPANICS

NCLR agrees that it is wise and prudent for the federal government to bring the Social Security system into long-term fiscal balance. In the absence of reform in the near term, the sheer size of the projected short-fall would likely impose severe economic strains on the federal budget and overall U.S. economy. Such economic pressure would undoubtedly translate into serious financial hardships for most Americans, and would have dire consequences for low-income workers—many of whom are Latino—typically more susceptible to economic downturns than higher wage earners. However, NCLR does not believe that the current system has major structural flaws or is programmatically outdated. Rather, NCLR understands that lawmakers should consider options to improve the system's effectiveness in providing a source of income for retirees and their survivors.

The Social Security system—which provides retired workers age 65 or older with a livable income—is designed, in part, to help alleviate poverty among elderly Americans and meet the retirement needs of workers (especially those who do not have access to, or are unable to participate in, employee pension plans). The program disproportionately benefits Latinos primarily because the overall socioeconomic picture of the Latino community closely resembles that of the nation in 1935 when the program was enacted. Today's Hispanic workers are concentrated in low-wage jobs typically lacking in pension coverage, experience high poverty and relatively high unemployment, and have less ability to save and invest for retirement than most other Americans. As a result, in 1996, the median income for Hispanics 65 and over was $8,036, compared to $12,921 for Whites and $8,656 for Blacks. Furthermore, that same year, 24.4% of Hispanics 65 and over lived below the poverty level, compared to 9.4% of comparable Whites and 25.3% of comparable Blacks.

Given this profile, Latinos fare better than most other Americans in the Social Security system for several reasons. First, Social Security's benefit formula is progressive, therefore, it ensures that low-wage workers receive a greater share of the resources that they contributed to the system. Second, benefits are based on the length of time worked, as well as on the level of reported wages and salaries earned, during a worker's lifetime. The progressive formula means that while low-wage retired workers receive a smaller amount in Social Security benefits than high-wage retired workers, the system compensates the burdensome nature of the payroll tax by replacing a greater share of a low-wage worker's lifetime earnings. According to the Social Security Administration, the proportion of annual earnings replaced by the system is about 60% for a low-wage earner, 42% for an average-wage earner, and 25% for a high-wage earner. Consequently, since Hispanics have relatively low earnings levels, they are more likely to put a smaller amount in, but receive a greater share of income from, Social Security than either Whites or Blacks. In addition, because Latinos tend to have longer life expectancy rates than other Americans, they are especially likely to receive benefits for a longer period of time, which helps them recover the proportion of income they contributed to the system. In short, the labor force and demographic picture of Hispanic workers and retirees actually results in a higher rate of return on investments for Latinos in the Social Security system.

Nevertheless, because benefit levels are low, the Social Security system has not met its goal of reducing poverty among elderly Latino and Black retirees. To illustrate, the Hispanic elderly population is more likely than Whites, but less likely than Blacks, to be poor; in 1996, about one-quarter of Hispanic (24.4%) and Black (25.3%) persons aged 65 years and over were poor, compared to fewer than one-tenth (9.4%) of their White peers.

III. SOCIAL SECURITY REFORM AND LATINOS

In 2013, soon after the number of retirees starts increasing by more than one million per year, it is projected that Social Security will begin to pay out more in benefits than it collects in payroll tax revenues. In the absence of reform, the federal government will need to borrow from the Social Security trust fund (accumulated reserves) in order to continue to pay necessary benefits. It is projected that in 2032, shortly after the youngest of the baby boomers is of retirement age, the trust fund will be depleted and revenues will support only 75% of guaranteed benefits. Based on these projections, policy intervention is necessary to ensure that neither American workers nor the economy are adversely affected.

Lawmakers have examined and proposed policy options that bring the system into long-term balance and which, in some cases, are designed to improve the financial outcomes for retirees. While some reformers have closely examined the impact of plans and proposals on low-wage workers—lending due consideration to the social insurance mission of the Social Security system—few have examined the impact of reform specifically on Latinos. Instead, policymakers, both progressive and otherwise, have tended to lump Hispanic concerns into the all-encompassing "low-wage/minority issues" category. Yet, Hispanics are, and will continue to be, a significant segment of the American work force, whose productivity, savings, and investments help to ensure the continued economic prosperity of the nation. In this sense, Hispanics are not simply part of the low-wage workforce, but an exponentially growing segment of America that currently experiences serious economic challenges. Therefore, any long-term Social Security "fix" that purports to help the majority of Americans but harms Latinos disproportionately will not be beneficial to the nation over the long run. Moreover, any long-term Social Security solution that does not address, in some manner, the economic and employment challenges that Latinos currently face will not be fully successful.

Accordingly, NCLR has outlined below several essential considerations, from a Latino perspective, that should be central to Social Security reform:

- Financial Security. Social Security invests a worker's payroll taxes in government securities. There is very little risk to these investments, except for the extremely unlikely possibility that the U.S. government will fail to honor its debts. Under the current system, benefits are guaranteed to be paid upon retirement and the amount is tied closely to wages earned over a worker's life. Several reform options inject a measure of risk by proposing to invest part of an individual worker's contribution into the stock market in the hope of generating greater returns on their investments. Under such models, benefit levels are not guaranteed and the value of one's retirement package is at considerably greater risk than with the current Social Security system. Because Latinos tend to be the least likely of all Americans to receive private pension coverage, the guarantee of a benefit upon retirement is critically important. In 1996, Hispanics 65 years of age and over received only 13.5% of their income from pensions, compared to 18.3% for Whites and 18.1% for Blacks. Moreover, according to Department of Labor (DOL) employee pension coverage data, while there were about 12.3 million Hispanic Americans in the workplace in 1997, only about one-third (32%) participated in employee pension plans, compared to more than two-fifths (44%) of other minorities and one-half (51%) of Whites. In fact, DOL reported that between 1979 and 1993 the rate of pension participation for Hispanics declined five percentage points, compared to a one percentage point increase for Whites. Therefore, a guaranteed and defined benefit is an essential component of any reform plan that considers the interests of Hispanic workers.

- Retirement Income and Rate of Return. Many reformists have focused on Social Security's rate of return as a key issue. As previously mentioned, NCLR believes Latinos—due to their low wages and high life expectancy, coupled with the Social Security system's progressive benefits formula and guarantee of life-long benefits (with cost of living adjustments)—receive a higher rate of return on Social Security benefits than other Americans. Moreover, because the benefit formula is tied to earnings during working years, Hispanics maintain high-income replacement rates; thus, a Latino retiree is likely to receive a substantial proportion of the earnings s/he made the year prior to retirement. Such an approach helps to maintain a worker/retiree's standard of living. However, it is precisely because the formula is based on wages over a lifetime that Social Security does not effectively prevent poor workers from becoming poor retirees. But disproportionate poverty among retirees who earned low wages as workers is not necessarily a result of Social Security's rate of return on payroll taxes. Rather, high poverty among elderly Hispanic Americans is due more to the fact that Hispanic and other low-wage workers lack access to private pensions and have little opportunity to save and invest for their retirement; two important sources of supplemental retirement income. As a result, Latinos tend to rely heavily on Social Security as the sole source of retirement income. Efforts to improve access to private pensions and increase personal savings and investment by low-wage workers, including many Hispanics, should be distinct from, but closely parallel, Social Security reform efforts.
- Equity. Overall, the current system is very progressive because low-earners—and Hispanics in particular—fare better than high-earners in terms of rate of return on investments and income-replacement rates. Yet several reform proposals, most notably "privatization" or "private individual saving account" plans, include provisions that would alter the progressive nature of the current system. These plans would create an exponentially more favorable structure for high-earners than low-earners by providing substantially higher returns for high-earners (largely because the benefit level of a defined contribution plan is principally dependent on the amount of contributions made over a lifetime). This transformation may have serious implications for the distribution of wealth in the nation. No policy option under consideration should seek to re-distribute benefits unevenly, widen the wealth gap between upper and lower-income Americans, or increase elderly poverty.
- Hispanic Women. While Social Security reform has serious implications for the overall Hispanic community, Hispanic women may be the most severely affected by reform efforts. Hispanic women are more likely than other women to work inside the home and are less likely than other women to have saved for retirement. Moreover, Hispanic women are less likely than other workers to have access to private pension coverage, they tend to rely heavily on Social Security benefits, and they tend to receive the lowest wages of any group of workers. As a result, changes in marital status or loss of a family member who is a principal wage-earner places Latinas in a particularly vulnerable economic position. In 1997, more than one-quarter of Hispanic women 65 years of age and older lived below poverty—while in households with a female householder over 65 years of age and no husband present, the poverty rate was 50%. Consequently, reform plans that threaten the economic status of retirees by making direct changes to the structure of the Social Security system—and also the survivors benefits system—will have a disproportionately harmful affect on Hispanic women.

Finally, for Hispanics overall, there is one additional issue related to Social Security reform that policymakers must consider. Specifically, it is generally accepted that raising worker productivity—thereby increasing payroll tax contributions—

would go a long way toward reducing the projected long-term Social Security imbalance. Because Hispanics will play a crucial role in supporting and promoting the nation's overall economic growth, Social Security reformers should seek to increase the productivity of current and future Latino workers. The data reveal that about three in five (59.9%) Hispanics between the ages of 18 and 34 had graduated from high school in 1996, compared to four in five Whites (83.6%) and Blacks (79.0%). Similarly, while 9.3% of Latinos had graduated from college in 1996, by contrast, 24.3% of Whites and 13.6% of Blacks had completed college that year. Given the direct link between educational attainment and income, earnings, wages, and disposable income for savings, increasing the educational attainment of Hispanic workers will directly enhance the solvency of the Social Security system.

IV. SPECIFIC SOCIAL SECURITY REFORM OPTIONS: IMPLICATIONS FOR HISPANICS

Experts suggest, there are only three legitimate ways to reform the Social Security program and bring it into long-term actuarial balance: increase revenues (i.e., payroll taxes, etc.), cut benefits, or utilize federal budgetary surpluses to strengthen the Social Security Trust Fund. Keeping in mind the aforementioned concerns for Hispanics, NCLR examined three broad policy options that are likely to be included in a final package of Social Security reform initiatives. In addition, we reviewed an alternative reform proposal to restructure the Social Security system to increase rates of return on worker investments.

Payroll Tax Increases

Perhaps the most rudimentary Social Security reform policy option, a payroll tax increase, is politically unpalatable to most lawmakers. Nevertheless, because of its simplicity, a modest payroll tax increase may be included in any serious Social Security reform package. As detailed in a 1997 NCLR report, Burden or Relief? The Impact of Tax Policy on Hispanic Working Families, federal payroll taxes already extract a disproportionately large share of income from Latino families because they are levied at a flat rate. For example, in 1995, Hispanic families in the lowest income bracket (quintile) had their incomes reduced by 6.6% by the payroll tax. NCLR opposes payroll tax increases and we believe that without a corresponding payroll tax relief package for low-wage workers, a significant tax increase would seriously and unfairly diminish the economic status of Latino workers and low-income families.

Benefit Cuts

There are a host of proposals and strategies to reduce the amount of benefits Social Security pays out to retirees. These include increasing the retirement age, modifying the cost of living adjustment, and altering the benefit formula. Because Latinos disproportionately rely on Social Security as the sole source of retirement income, and often receive lower benefits than other Americans, reductions in benefits would have serious negative implications for Latino retirees. NCLR opposes benefit cuts. If any such cuts occur, reformers must strike the right balance between fairly distributing the impact and burden of reform efforts, and harming vulnerable retirees. We expect that policymakers will apply any benefit cut initiatives progressively, to avoid imposing disproportionate economic harm on poor elderly retirees.

Unified Federal Budget Surplus

The Clinton Administration has proposed, and several Congressional leaders have agreed, to carve-out 62% of the unified federal budget surplus to fortify the Social Security Trust Fund. The Administration's plan would use projected budget surpluses to pay down the national debt. Most experts agree that reducing public debt enhances the prospects of sustaining long-term economic growth. While the proposal does not bring the Social Security system into 75-year fiscal balance, it moves close to long-term balance without imposing deep benefit cuts or steep payroll tax increases. In addition, the proposal does not significantly modify the structure of the Social Security program; a move that could have far-reaching negative affects on workers and retirees. NCLR believes that reserving a significant portion of the budget surplus to build up the Social Security Trust Fund, and using resources to pay down the national debt, is a sound and prudent plan that should be supported by Congress.

Mandatory Private Individual Accounts

There are a host of proposals that create mandatory private individual accounts that would be de-facto retirement savings accounts that could be invested in common stocks and bonds. Proponents of these plans suggest that such accounts would increase the rate of return on investments for retirees, increase national savings, and boost U.S. economic growth. However, there are several factors that suggest that such an option may not proportionately benefit Hispanic workers; specifically:

• Investment Expertise. While it is unclear what investment choices Hispanics will make (which determine their final benefit amount and rate of return), research shows that Hispanics have limited experience with, and exposure to, private investments and financial institutions in general. For instance, data from the Employee Benefits Research Institute's 1998 Retirement Confidence Survey show that only one in five Hispanics has tried to figure out how much they will need to save for retirement. A similar proportion indicated that they are not comfortable dealing with banks, insurance companies, or mutual funds. Given this, it is likely that under such a system Latinos would seek investments in the most risk-averse portfolios—which also happen to maintain the smallest long-term yields.

• Administrative Costs. These accounts would be subject to administrative costs that would further erode the rate of return; and most analysts agree that such costs are reasonably higher in private market investments than under the current system. These costs would have a disproportionately greater adverse effect on the relatively smaller account that Hispanics, due to their relatively lower contributions, would have.

• Economic Status. There are several issues that will affect the ability of Latinos to save and invest in such accounts. As a group, Hispanic workers have variable work histories, due to high levels of unemployment, displacement from jobs, and work in unstable industries. Mandatory private accounts require consistent, stable employment to ensure steady contributions; for Hispanics, such changes over a lifetime would vary and ultimately hinder long-term returns. In addition, Hispanic workers are less likely to have health insurance than any other group of Americans, which means that at least one in three Latinos has to use a significant amount of earnings for out-of-pocket health care costs. Similarly, almost one in five Latinos spends almost half of his/her income on housing. The lack of health insurance, coupled with high housing costs, seriously diminishes disposable income available to hispanics for saving and investing.

Furthermore, any major structural change in the Social Security program would impose serious economic burdens on current workers. The transformation of a system from one that uses current contributions to pay the benefits of current retirees to one that builds accounts for current workers would have to be financed. In addition, private individual accounts are likely to alter significantly the progressive nature of the system; specifically, high-wage earners will fare much better than low-wage earners in a defined-contribution system, which would exacerbate the wealth gap, with nation-wide social and political implications. NCLR believes that the creation of mandatory private accounts is not likely to benefit Latino workers and retirees over the long run. As a result, NCLR is inclined to oppose the creation of mandatory private individual accounts within the Social Security system.

V. SOCIAL SECURITY REFORM RECOMMENDATIONS

Overall, given that the final Social Security reform package may contain measures that directly reduce benefits exiting the system and increase revenues entering the system, NCLR will support the most progressive means of bringing the system into long-term fiscal balance. Of utmost importance to Latinos is maintaining the social insurance nature of the current system. Therefore, the best Social Security reform package for Latinos would retain the equity and progressivity of the current system and maintain a guaranteed benefit upon retirement.

Nevertheless, NCLR suppors the goals of the majority of Social Security reform proposals that attempt to imporve the ecomic status of elderly retirees and increase the retirement savings rate of Americans. However, we are not convinced that a dramatic change in the Social Security program is the only, much less the most appropriate, course to achieve these goals; on balance, we believe this would do more harm than good. From NCLR's perspective, poverty levels among hispanic elderly retirees, increase the retirement savings rate of Hispanic and other low-income Americans, and increase the productivity of Latino workers. Such steps are critical not just to ensure a decent source of income for Hispanic retirees, but also to help sustain the economic growth of the national as a whole.

Bearing this in mind, we applaud President Clinton's proposal to use a large portion of projected federal budget surpluses to preserve Social Security while investing a modest portion in programs designed to promote the future productivity of the workforce. We believe it is an important first step, and should go a long way toward moderating the potentially harmful economic effects of bringing the Social Security system into long-term fiscal balance. In addition, while we have some questions regarding the details of his plan, we support the general thrust of President Clinton's proposal to create Universal Savings Accounts to increase the persoanl savings among all Americans.

As the nation's demographics change, the Latino population will be an increasingly significant driving force behind America's social, economic, and public policy agendas. With this in mind, NCLR appreciates the opportunity to submit this statement, and strongly encourages Congress to consider and include the perspectives and concerns of the 30 million Hispanic Americans in the unfolding national debate on retirement issues. We also welcome you to call on NCLR to provide additional information about the economic well-being of Latino workers and future retirees. Thank you.

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Chairman SHAW. Thank you.

Mr. Beach.

STATEMENT OF WILLIAM W. BEACH, DIRECTOR, CENTER FOR DATA ANALYSIS, HERITAGE FOUNDATION

Mr. BEACH. Chairman Shaw, Members of the Subcommittee, it's a great pleasure to be with you today. My name is William Beach, with the Heritage Foundation. It's especially a pleasure to be with my fellow panelists. We have been disputing these points on Social Security in a very friendly manner over the past year, and we will continue, I am assured, to be very friendly with one another.

Mr. Chairman, I am also going to take the risk of giving you extemporaneous remarks. Many of the things that I had planned to read to you today you have heard from Eric, and Kilolo, and Dr. Spriggs, and Roberto.

We agree on so many points that I hope this discussion will bring those points to this Subcommittee's attention. It's very important that you understand the common ground.

Second, I would like to begin by addressing some prejudgments that I have heard today in this set of testimony and in testimony prior to this panel.

Reformers, like myself, will not support any change to disability insurance or preretirement survivors insurance as part of this reform. In all of our analysis that we have done at the Heritage Foundation, we have held harmless disability insurance, preretirement survivors insurance, and the 22 other programs that Social Security currently administers because we want the attention of this Subcommittee and other Committees on this Hill to be on retirement. I am going to address that in a moment.

Second, we will not support, nor will we encourage, a solution to Social Security that's done through the payroll tax window for obvious reasons. This is a tax that is especially burdensome on low- and moderate-income Americans and this is a tax that—this is a program that is especially designed for low- and moderate-income Americans.

Third—and there are many other principles in my printed testimony—we believe that whatever changes are made to the program should be made in such a way as to leave current beneficiaries with all of the benefits they have been promised and near beneficiaries, however you define that, those who are coming on to retirement, with promised benefits. There are costs involved to making any change but, gentleman, there are costs to not making changes.

Now, sometimes I think when I work this issue that I'm actually involved in reforming the trust fund. That's when I'm inside the Beltway. When I'm outside the Beltway, I know something else. Let's keep a clear focus on what's at stake here. OASI, the Old Age and Survivors Insurance Program is the dominant retirement program of low- and moderate-income Americans. To define moderate, somewhere around $35,000 and below.

It wasn't intended to be that way. There was a three-legged stool in 1935. One leg was pensions through the place of work. The second leg was savings and you have heard of this from Kilolo. The third leg was Social Security. And, in fact, the President at that time insisted upon this, and Arthur Altmeyer said, once one leg of the system begins to crowd out the other legs, then we have to look at Social Security very, very carefully.

But payroll taxes have risen very high, and they could rise higher—12.4 percent currently supports OASDI—10.6 percent just supports the OASI Program alone, and that is crowding out savings for low-income households and for many moderate-income households. Why else do we have 40,000,000 households in this country that are covered by Social Security without savings programs in any form?

Dependency on Social Security because of tax rates, because of economic discrimination, because of what else has now made Social Security the dominant program of retirement for low- and moderate-income Americans. And the moment we lose that focus, we are going to lose the correct emphasis in this debate.

Now, why is that an important focus? Here, I think is the point upon which there may be some departure, but I hope not. There are many people, including myself, who are not going to depend on Social Security. I'm going to depend on it somewhat, but I have supplemental retirement programs. I've got 401s. I've got a pension maybe if I stay at Heritage long enough. After today, they may not want me there.

I'm able to enjoy the benefits of higher rates of return in markets, in funds; that because I have the funds, I can invest in. But if you are solely dependent upon Social Security for your retirement program, and your rate of return is lower than the 3 percent that you can get on a CD, lower than your nominal order of withdrawal checking account, then you're going to fall further and further behind in the economic race. There may be an argument to make that Social Security—the retirement program, just the retirement program could be adding to the gap between the rich and the poor.

We need to create a savings element within Social Security—make it 2 percent, make it 3, make it 4 percent—that will provide at least some emphasis, some ability of people to go into the bond market, U.S. Treasuries, where you can earn slightly higher rates of return, or into a mixed portfolio of bonds and equities. We believe there ought to be a two-tiered Social Security system. Part A with a savings element, somewhere in the neighborhood of 3 or 4 percent. And part B is the program we have now with the progressive formulas, with all of those sorts of things that would be maintained by the rest of the system.

This debate is really very important. It's important because we're debating the retirement program for tens of millions of Americans. And as long as we keep our focus on that, as opposed to some other things, then I think we'll come out all right.

Thank you very much.

[The prepared statement follows:]

Statement of William W. Beach, Director, Center for Data Analysis, Heritage Foundation

So fertile has this century been in producing great events that many subtle though equally important developments may escape notice by historians. What memorial on the Twentieth Century would be complete without comment on the dramatic changes in family structure and gender roles that people in industrialized countries have experienced? What would a history of Twentieth Century America be like without a critical inquiry into the expansion of racial and ethnic diversity? Or, what future student of our times would understand us without learning about our commitment to publicly insuring all of our fellow citizens against the economic hardships that often attend disabling accidents, illness, and old age?

The curious thing about history is that the living are the authors, in a sense, of their own epitaphs. We may, therefore, appropriately ask, how will our stewardship be judged? We can do nothing, of course, to change the fiber of this century's brutal conflicts or to improve on our frequently brilliant and sometimes dull economic performance. We may also be powerless to shape the larger demographic trends. However, those commitments that transcend generations clearly are within our powers to mold.

Few of the commitments made in the Twentieth Century rise higher in significance than those made in 1935 through the Social Security Act. Not only did Congress and the President fundamentally alter the course of public policy by aligning it with the principles of private mutual aid, but they also established a virtually irrevocable promise to future generations. Today's workers insure themselves against certain vagaries of their future economic lives by supplying tax dollars for those in need. Social Security is the quintessential intergenerational insurance program. In exchange for lower incomes, current workers shift the provision of their own future retirement needs onto the earnings of future workers.

In the beginning, this arrangement worked very well. Social insurance programs complimented work and health insurance provided by employers and private savings. In fact, the founders of Social Security (including President Roosevelt) insisted that the Old-Age and Survivors Programs must always be one of three legs to the insurance stool: private aid, mutual aid, and social aid. In fact, OASI's first director, Arthur Altmeyer, believed that Social Security should change if it ever crowded out either of the other two legs.

I believe we have reached the point that Altameyer feared. Demographic trends unimagined by the System's founders combined with numerous expansions of Social Security's original mandate now threaten the future of this important commitment. It is altogether possible that a failure to change the retirement portion of the Old-Age and Survivors Insurance program will lead to significantly higher taxes on low and moderate-income workers. A failure to act now also may lead to lower retirement income for all beneficiaries and longer work lives before retirement. The system's challenges are, indeed, numerous.

- Social Security's founders established a statutory retirement age of 65 at a time when average life expectancy stood at 61 years. They also had no idea that an explosion of population loomed just ten years after Social Security's creation. The largest generation of workers in world history is steadily approaching retirement in better health than any preceding generation in world history. By 2010, nearly 70 million "baby boomers" will begin drawing Old Age benefits from Social Security. In fact, the fastest growing segment of the population by 2020 will be people older than 75. If nothing changes between now and then, this draw on public resources will force a substantial reduction in our commitment to social insurance, particularly publicly provided medical care. The estimates of how much this "draw" amounts to vary, depending on which of several economic and accounting model you choose. No one can take comfort, however, is any part of the range of the "unfunded liability" estimates. Prominent actuaries and economists put the amounts of future payments between $4 trillion and $11 trillion dollars (after inflation). Indeed, no change in the current system could mean a forty-percent increase in payroll taxes over the next twenty years.

• Unfortunately, this same post-World War II generation failed to reproduce itself, thus assuring that much fewer workers will be paying their parents retirement after 2010 than the system minimally needs. The currently retired population enjoys a dependency ratio of nearly 3.5 to 1. By 2030, this ratio will have fallen to 2 to 1. In 1950 the ratio stood at 16 to 1. This declining ratio may mean that benefits will be cut, which would result in many retired parents having to depend in larger part on the incomes of their children and grandchildren.

• The current population of retirees secured a retirement and medical care packages for itself that compete well with very good, privately financed programs. However, today's workers must pay historically high payroll taxes to fund this publicly supported retirement and medical program. These taxes fall heaviest on those workers in low and moderate-income households. They frequently crowd out the ability to create private savings, to make important investments in the education of children, and advance economically. "Fixing" Social Security by any of the traditional means (higher taxes, lower benefits, or longer working life) directly worsens the life of people at the bottom of the economic ladder.

THE HERITAGE FOUNDATION'S STANDARDS FOR SOCIAL SECURITY REFORM

Social Security needs to be reformed to deal with these problems. The reform should do two things: secure the ability of the system to deliver on its promises to beneficiaries, and enable today's workers to look forward to more income in retirement. To do this Heritage proposes the following reforms:

• Enact a Social Security contract between the government and citizens, specifying the benefits that today's and future retirees will receive (currently the Supreme Court says there is no right to benefits).

• Concentrate immediately on securing the retirement years of working Americans by raising the retirement income they can expect: make no changes in Social Security's disability and dependents program.

• Raise retirement income by allowing workers to place a portion of their payroll taxes now devoted to retirement income (but not disability etc.) into a personal savings/investment retirement account instead. Workers who exercised this choice would not receive the Social Security benefits associated with the portion of their taxes they placed in a private account, but they would receive the Social Security benefits financed by the rest of their payroll taxes.

• Require all personal retirement accounts to include an annuity at least equivalent to the Social Security benefits foregone by the worker. The annuity would have to be insured—with back-up insurance provided by the federal government.

• No worker would be required to open a personal retirement account.

All Americans, whether or not they opened a personal retirement account with a portion of their payroll taxes, would be entitled to a minimum benefit from the traditional Social Security.

Too frequently in the current debate over Social Security do the disputants forget for whom the system was especially designed. Social Security is the dominant retirement program for low and moderate-income American workers. The system's advocates from its creation clearly describe the program as social insurance for those workers at the greatest risk of not having adequate retirement income. Indeed, current law taxes wages and salaries only up to a level called the "maximum taxable income threshold," which today is roughly $72,600. This threshold indicates truth that workers making more than that amount have the means (and presumably the common sense) to create supplemental retirement savings. Current law also pays out benefits to low-income workers that nearly equals the average of their last few years of work, but pays a worker who earned above the maximum taxable threshold only 16 percent of their average earnings.

Discussions about "revenue neutral tax rates," "dependency ratios," and "closed economy trust fund projections" may escape a mind occupied with some other part of life. If so, take the comfort I take in a fact that those elements of the debate are secondary to how well the program serves low and moderate-income workers.

First, let me reiterate that my focus is solely upon the retirement portion of Social Security. I will not support any change to Social Security that alters the current funding or benefits of the Disability Insurance program or the other 23 programs administered by Social Security, such as the Pre-Retirement Survivors Insurance Program. I will assume in the remarks that follow that Congress leaves these programs alone or acts in a fashion as to improve them. Workers currently pay 12.4 percent of their earnings to support the Old Age, Survivors, and Disability Insurance program. Of this amount, 10.6 percentage points go to retirement and less than one percent goes to pre-retirement survivors insurance.

If we count the Medicare portion of payroll taxes, workers pay 15.3 percent of their earnings to support Social Security. For millions of workers, this percentage exceeds what they pay in income taxes. For about 30 million workers who have no income tax liability, this is their tax system. The payroll tax, however, is a flat tax of the worst sort: no deductions and, of course, no offsetting benefit retirement benefits payments that would make it "progressive." This regressive tax is a greater burden on those at low than at high-income levels. While other elements of Social Security (such as Disability Insurance and Pre-Retirement Survivors Insurance) offset the regressive nature of the taxes paid to support those programs, workers must wait all of their working lives to be compensated for the regressive nature of the retirement tax portion.

These high taxes also crowd out private savings. Some analysts believe that nearly 65 percent of current workers have no significant savings for their own retirement. The truth is simple: low and moderate-income Americans are dependent on Social Security for their retirement and, worse, believe that it will be there for them when they retire.

This state of affairs—high and regressive taxes and low personal savings—would be acceptable if Social Security glowed with the financial health of the Magellan Fund or, at least, assured current workers that they would receive a rate of return on their retirement payroll taxes equal to what the least savvy upper income investor makes. Sadly, however, the Old-Age Insurance program fails even that test.

If you are young, single male born in 1967 and earning the average wage of $28,400, your inflation adjusted rate of return from Social Security is .4 percent. If you are a similarly defined female, your rate of return reflects your long life expectancy, but it is still only .7 percent. Suppose these two people are married, both working, and living in New York with two children. Their rate of return from Social Security is a paltry .8 percent. They will pay about $395,000 in payroll taxes and receive about $506,000 in retirement benefits from Social Security.

Despite these low returns, you may be wondering why all the fuss. Clearly, these typical workers get more from Social Security than they paid in. The fuss is this. As long as someone else is free to invest $395,000 in, say, 30-year Treasury Bonds, and our typical couple is not; the higher income worker will get richer and the lower income worker will get poorer. Had Social Security allowed this average income couple to place their payroll taxes in a Treasury bond account earning only 2.8 percent after inflation, they would have $830,000 at the time of their retirement rather than $506,000, or $324,000 more.

If you are a young, single, African-American male, Social Security's retirement program contains little if any value at all. Due to lower life expectancies, many African-American males may not live long enough to collect benefits equal to their taxes. Such a low-income male born in 1970 has a rate of return of −.7 percent. That negative percentage means that the retirement program is more expensive for them than for someone with a positive rate of return. Indeed, this black male loses about $14,000 in the Old-Age Insurance program. Had Social Security allowed him to invest his payroll taxes in Treasury bonds, he would have at his retirement $79,800 more than Social Security promises to pay him. In other words, his participation in Social Security would not mean that he would fall further behind in the economic race.

A single Black female born in 1970 and making about $25,000 per year in taxable wages "enjoys" an inflation adjusted rate of return of .98. An African-American, married couple both of whom were born in 1970, work, earn average incomes and have two children also have a dismal rate of return: only 1.07 percent. Worse yet are African-American couples who earn above the maximum taxable income threshold. Their rate of return is −1.64 percent, after inflation.

Even though life expectancy is higher for Hispanic Americans, their rates of return under Social Security also are low. If Hispanic Americans were allowed to direct their payroll taxes into safe investment accounts similar to 401(k) plans, or even in super-safe U.S. Treasury bonds, they would accumulate far more money in savings for their retirement years than they are likely ever to receive from Social Security. For example, an average-income single Hispanic male born in 1975 who earned about $17,900 in wage, salary, and self-employment income in 1996 can expect to receive an annualized real rate of return from Social Security of just 1.44 percent. By contrast, he could expect to receive a long-run real rate of at least 2.8 percent from super-safe long-term U.S. Treasury bonds.

Social Security also pays a very low rate of return for two-income Hispanic households with children. A Hispanic, double-income couple that has two children, that was born in 1965, and that earns the average wages received by Hispanic Americans can expect a rate of return of 2.17 percent from Social Security during its lifetime. This rate contrasts with a return of 3.17 percent over the same period on an ultra-conservative portfolio composed of 100 percent U.S. Treasury bonds, or a return of 4.67 percent on a prudent portfolio made up of 50 percent broad market equities and 50 percent U.S. Treasury bonds. In terms of 1997 dollars, this couple could expect to receive $347,000 more in lifetime after-tax income from a portfolio composed equally of government bonds and broad market equities than it could from Social Security.

The rate of return has a damaging impact on communities. The cumulative effects of Social Security's low rates of return can be appreciated by considering a hypothetical community. Suppose there existed a city composed entirely of 50,000 young, married, double-earner Hispanic couples in their 30s in which each person earned the average wage for Hispanics and each couple had two children. The cumulative amount such a community could save in a private pension plan by retirement with the same dollars they currently pay in Social Security taxes is more than $12.8 billion greater in 1997 dollars than what these couples will get in Social Security benefits. This amount is roughly equal to half that the federal government currently spends on food stamps each year for the whole country and half as much as direct federal spending on education

These numbers should raise serious doubts about Social Security's ability to supply adequate income to future low and moderate-income workers without threatening their ability to advance during their working lives. They also should highlight a glaring deficiency in current law. Now that payroll taxes have risen to a point that crowds out private savings, these same low and moderate-income households have little give to the next generation. If payroll taxes have to remain as high as 15.3 percent of earnings, then Congress should change the system to create a savings element within Social Security. Not only should Social Security provide adequate income, it also should be a vehicle for creating wealth in low and moderate-income households.

Chairman SHAW. Thank you.

Mr. Hulshof.

Mr. HULSHOF. Thanks, Mr. Chairman. I'm now understanding the importance of getting here early, and being the first one here.

Chairman SHAW. You're senior. Go ahead.

Mr. HULSHOF. I appreciate that very much. Mr. Beach, thank you for actually pointing up the common ground, because as I've heard from various testimonies some of those discrepancies, and I also want to say that we do applaud the fact that the President has at least entered the discussion about this issue.

Mr. BEACH. Yes.

Mr. HULSHOF. I was proud to have been the Republican Member of the House at the first town meeting, if you want to call it that, in Kansas City with the President. And yet, Dr. Spriggs, in your testimony you mention "thanks to the downpayment on the problem that President has proposed, drastic changes are not necessary given the size of the problem." Now, I listened to the State of the Union, and I agreed until we began to listen to expert testimonies. And I'm not—it's unfair of me to ask you to comment on witnesses that we've heard. I know that Mr. Doggett, with the last panel mentioned it. In fact, Ms. Kijakazi also cited specifically Henry Aaron, who when I saw him on the witness list thought I was going to get an autograph. I thought it was the baseball player when, in fact, the economist from Brookings, but here's what Dr. Aaron told us just last week: "The President's plan actually advances"—that is, moves forward—"Social Security's day of reckoning." In other words, instead of 2013, we're moving the time line ahead, instead of back in that the President wants to eliminate the earnings limit, which I think there's a lot of support for here, but second, raising benefits for elderly women. And in the expert opinion of Dr. Aaron, it actually makes Social Security's immediate problem worse rather than better.

Yesterday, on the Senate side, and again, talking about being here early, getting here early to Washington and getting to watch C–SPAN yesterday, the GAO Comptroller General, Mr. Walker, testified that the President's proposal would actually require our children to pay higher income taxes.

I do think we have a lot of common ground about what we don't want to see. We don't want to see higher payroll taxes, as Mr. Beach has said. We don't want to cut benefits and probably don't want to tap into the general revenue funds or the income taxes.

One of the things you suggest is increasing the cap on FICA taxable income to historical levels. Let me just ask you this, because this was something that came out at the national town meeting that I participated in: The unique feature of the Social Security system is that it is not a welfare system. The President himself talked about the fact that, if Michael Jordan, using as an example before Mr. Jordan retired form NBA, that he is entitled to take out of the system at least partly what he has paid into it, because this is not a social system.

Does the National Urban League continue to ascribe to that fundamental principle of the Social Security system, that it should not be a type—and I don't know how else to say it—but a type of welfare system?

Mr. SPRIGGS. I don't think the redistributive nature or the fact that low-income workers benefit more than high-income workers is really a welfare aspect. I think that that is the insurance aspect. As such, having paid an insurance premium, then everyone should be able to collect on that insurance.

Part of that insurance program includes an annuity. When we stopped collecting taxes on the full 90 percent of wage income, that meant there are now some workers who previously would have been paying more taxes into the system, so we are going to have a cohort, who are going to get the maximum benefit, even though they would not have paid the same amount of taxes that would have been historically the case that other workers paid.

So, in suggesting that we restore the cap to its historical level, it is just saying, for that cohort, let's have you contribute to get the maximum benefit what we have asked workers in the past to pay, in terms of how we looked at our income distribution.

The fact that our economy is doing well, and many of you in the room take credit for that all the time, means that you have generated more people who are in that higher income. But the nominal income cutoff level no longer captures 90 percent of wage income. So, they ought to actually be saying thank you to you for giving them that higher income. Now you are just asking them, in fairness, let's restore the balance that we had before.

Chairman SHAW. The time of the gentleman has expired. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman.

I don't want an answer from you, Mr. de Posada, but I just want to point out, I have just observed something here. In your testimony—and you can get back to me in writing, or maybe the Committee in writing—you speak about an individual working full time from Galveston, Texas, making $20,000 a year will collect, if my calculations are right—and I did it two or three times—retirement benefits of $32,880 a year, about 150 percent of one's income. I find that to be incredible; it's unbelievable. But I will take your word for it.

But what I would like you to do, will you back up this statement with an actual—obviously, the Retirement Fund cannot give an individual's name, but I would like to know where this data came from. If you could send it to my office, or perhaps the Committee, Majority and Minority, if they want it—I don't know if they want it.

Then, also, I might just point out that there is a GAO study coming out on Galveston that, at least preliminarily, has indicated some skepticism about the benefit level. But, I, again, won't get into that, because I don't want to debate Galveston. That will be at another time.

But I would like the information to back this paragraph up.

[The following was subsequently received:]

HBR

HISPANIC BUSINESS ROUNDTABLE

February 19, 1999

The Honorable Clay Shaw
Chairman, Subcommittee on Social Security
Ways and Means Committee
B-316 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Shaw:

On behalf of the Board of Directors of the Hispanic Business Rondtable (HBR), I would like to thank you for the opportunity to participate in the February 10th hearing. As I mentioned during my testimony, Social Security reform is one of our top priorities for the 106th Congress.

As per Mr. Matsui's request, enclosed please find an April 30, 1997 testimony before the Subcommittee on Securities of the Senate Banking Committee from Mr. Kebodeaux, Chairman of the Board of First Financial Capital Corporation, regarding the alternative plan for Galveston County. This testimony was the source I used during my testimony before your committee.

I would have been happy to provide Mr. Matsui with this information during the hearing, but as per his request, I am forwarding it to you.

HBR is in the process of commissioning an economic impact study on the benefits of personal retirement accounts in the Hispanic community. Upon completion, I will send you a copy. Should you have any questions or need additional information, please feel free to contact me at 703-684-5100. I look forward to working with you on this important issue in the future.

Best regards,

Roberto Garcia de Posada
Executive Director

Enclosure

611 Pennsylvania Avenue, S.E. • Suite 196 • Washington, D.C. 20003 • Tel. 202.546.1284

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Prepared Testimony of Mr. K. D. Kebodeaux, Chairman of the Board, First Financial Capital Corporation, Senate Banking, Housing and Urban Affairs Committee, Subcommittee on Securities, Oversight Hearing on Social Security Investments in the Securities Markets, April 30, 1997

The Alternative Plan for Galveston County, Texas

PART I—POLITICAL PROCESS FOR ADOPTION OF PLAN

The Commissioners Court of Galveston County is an elected body of the county consisting of a County Judge and four Commissioners.

The Commissioners Court contracted with First Financial Capital of Houston to present an alternate proposal to the county, should the employees elect to change from the United States Government program to a full private plan.

Public hearings were held with employees to compare the alternate plan with the existing Social Security program, both plans were presented in detail by the private company (First Financial) and representatives from Social Security.

The employees voted 77% in favor of the private plans—Commission Court then authorized First Financial private company to proceed to implement the program and for the county to finalize the withdrawal from Social Security.

PART II—PLAN DESIGN—FIRST FINANCIAL CAPITAL CORPORATION

First Financial Capital Corporation was commissioned to replace an existing plan sponsored by the Federal Government. We were to offer the same type of benefit using the same contributions but with better results.

The Alternate Plan consists of Disability, Survivorship and Retirement Benefits. The plan is based on contributions made by the participating employee and the employer (County of Galveston).

The employee's contribution to the plan is 6.13% of eligible gross annual compensation. The employer (County) will contribute 7.785% of compensation.

ELIGIBIILITY FOR ENROLLMENT

An employee is eligible for enrollment in TheAltemate Plan when the employee is actively at work, and scheduled to work 20 or more hours per week on a permanent basis (unless otherwise noted for individual benefits).

PLAN CONTRIBUTIONS

A—Disability and Survivorship Benefits

The Plan's disability and survivorship benefits are provided to the eligible employee at no cost to the employee. The premium cost of this coverage will be paid by the employer.

Disability and Life Insurance coverage for the eligible employee will begin on the first day the employee is actively at work. Accumulations of the retirement benefits under THE ALTERNATE PLAN BEGIN with the first deposit to the Deferred Compensation Plan Account.

B—Deferred Compensation Retirement Benefits

The Plan's retirement benefit is funded through tax-deferred contributions made by the employee and the employer. The required employee's contribution is 6.13% of eligible gross annual compensation which is deposited into the employee's Retirement Annuity Account. The employer also contributes an amount to the Retirement Annuity Account. The amount of the employer's contribution will be 7.785%, less the cost of the employee's Life and Disability Insurance premiums. (Approximately 3% to the retirement plan from the employer)

BENEFITS

A—Survivorship Benefits

The Group Term Life and Accidental Death and Dismemberment Policy provides benefits under the following programs:

Schedule of Life Insurance and Members regularly scheduled to work 40 hours each week:

Under Age 70	300% of employee's ANNUAL EARNINGS with a minimum benefit of $50,000 and a maximum benefit of $150,000.
Age 70–74	200% of employee's ANNUAL EARNINGS with a minimum benefit of $33,330* and a maximum benefit of $100,000.
Age 75 or older	130% of employee's ANNUAL EARNINGS with a minimum benefit of $21,665* and a maximum benefit of $65,000.

* If a FULL-TIME MEMBER who has 10 years service prior to attaining age 70, the LIEFE INSURANCE will be a minimum of $50,000. If a FULL-TIME MEMBER who attains 10 years of service after age 70, the LIFE INSURANCE will have no further reduction.

Schedule of LIFE INSURANCE for MEMBERS regularly scheduled to work 20 but less than 40 hours each week:

Under Age 70	150% of employee's ANNUAL EARNINGS with a minimum benefit of $25,000 and a maximum benefit of $75,000.
Age 70–74	100% of employee's ANNUAL EARNINGS with a minimum benefit of $16,665 and a maximum benefit of $50,000.
Age 75 or older	65% of employee's ANNUAL EARNINGS with a minimum benefit of $10,832and a maximum benefit of $65,000.

B—DISABILITY (Monthly Income Benefit)

After a 180-Day elimination period, the totally disabled insured will receive 60% of base pay up to a maximum benefit of $5,000 per month. There is a minimum benefit payable of $100 per month.

C—Schedule of RETIRED LIFE RESERVE, (RLR) BENEFITS for full-time members with eight years of service to employer:

Post Retirement Death Benefit for Active, Full-time Employees (2080 hours per year), who have accrued a minimum of eight years of service to the employer.

The Plan provides a Paid-up Death Benefit to employees who retire after reaching the earlier of:

- Rule of 75 where Age plus Years of Credited Service total 75;
- Age 60 with eight Years of Credited Service; or
- Accumulate at least 30 Years of Credited Service.

BENEFIT

Age 55 and Younger	$25,000
Age 56	$27,500
Age 57	$30,000
Age 58	$32,500
Age 59	$35,000
Age 60	$37,500
Age 61	$40,000
Age 62	$42,500
Age 63	$45,000
Age 64	$47,500
Age 65 or Older	$50,000

D—RETIREMENT INCOME BENEFITS

Employees retiring at normal, late or early retirement will receive their retirement income from their Deferred Compensation Plan Account. All contributions, plus interest earned, will accumulate to provide this retirement benefit.

Retirement Benefit—25 years old, working 40 years, retiring at age 65

Average Annual Income	$20,000	$30,000	$40,000	$50,000
Accumulated value at Retirement	$383,032	$573,782	$765,042	$956,303
Lifetime Monthly Benefit at Retirement	$ 2,740	$ 4,106	$ 5,474	$ 6,843

*Above assumed interest rate of 6.50% (no Equity Investment)

(Note: Social Security maximum is $1,280 per month)

The employee who is retiring from service or terminating employment may choose from several payment options available. These include, but are not limited to, monthly distributions of lifetime payout. The departing employee should consult with the Plan Administrator prior to electing any distribution option.

PART III CONCLUSION

Social Security consists of Retirement, Disability, and Death (Survivors) benefits. The Alternate Plan also offers the same benefits but is superior in each category.

Comparison—Maximum Benefit

	Social Security	Alternate Plan
Death	$253.00 Lump Sum	$50,000 Minimum $150,000 Maximum $75,000 Average
Disability	$1,240 Per Month (If Qualified)	$2,749 Average
Retirement	$1,280 (1996) Subject to Cost of Living Adjustment. * Additional Benefits May Be Alternate Program.	$4,790 Average
	Paid to Spouse & Children (If Qualified).	Vested Each Employee's Spouse & Children

Mr. MATSUI. Let me just make one observation. The President has put out his plan, and it has been subject to a wide range of criticism—double accounting, $5.1 trillion is going into it, the whole issue of investments. So far, what we have had, Mr. Beach—and I want to ask you this—is that we have had comments about individual investments will be great for America or great for the individual, but then we don't have a plan.

Here's what my problem is, and, you know, I want to solve this; I think we all want to solve this. I like your good-faith offer. But you don't want to make any change in the disability survivors' benefits. You are just talking about the retirement portion of this.

Now if you take 2 percent or 4 percent, whatever it may be, you have a huge transition cost. Mr. Aaron says that transition cost is anywhere from $3 to $8 trillion. Mr. Rubin says now it is $8.5 trillion. So that has to be paid somehow, if you want to maintain current benefits. And nobody wants to cut current benefits. Somebody has got to address that issue. The President has addressed that issue, because he doesn't reduce benefits.

Second, you have got to deal with this: You take 2 or 4 or 3 percent off of the level of benefits. At the end with the private pension part of the program, are you going to have that converted into an annuity? If it is in the form of an annuity, how do you guarantee the CPI index. Hispanics, demographically, live longer in retirement than any other group, including the white community. That means, if somebody lives 20 years in the Hispanic community, they don't get the inflationary increase, although rents go up; cost of living goes up; everything goes up. So they end up losing, if they live 20 years, maybe a significant sum.

I need to know how these thing are dealt with, if you want to support individual accounts. And maybe you can just briefly answer, because I want to ask a couple of other questions.

Mr. BEACH. Surely.

Mr. MATSUI. Maybe you can address this. What is your entire plan? Do you set up an annuity? How much does that cost? Mr. Aaron says that costs 20 percent of the total cost of the package. Then, obviously, I think it was Ms. Kijakazi who indicated that Mr. Aaron also talked about 20 percent being the cost of maintenance of one of these accounts. So you are talking about losing perhaps 40 percent off the top before a person even can annuitize his retirement benefits. These questions have to be answered. We just can't be throwing around numbers, talking about how lovely it is to give individuals chances.

Mr. BEACH. You are absolutely right. There are far too many questions there, Mr. Congressman, for me to answer in just a few minutes, but let me point to a couple of things.

First of all, besides making certain that the income and retirement in the future—say 2030—is the same as is now promised and better, there should be more income, we need to also make certain that the reforms also create wealth in low- and moderate-income households, so that we can begin to have intergenerational wealth transfers in places like the Crenshaw district of Los Angeles. Now those are important objectives. How do we get there?

We published a paper on July 1 of last year, which I would direct your attention to, and I'll make sure your staff gets a copy of it, in which we have a 5-percent proposal. Now we don't have a plan. There is no Heritage plan yet, but we put a scenario out for that.

I think that is a very interesting plan, and transition costs are addressed. Administrative costs, transition to an annuity, are addressed in another paper which we published in August, and we have some dispute with Mr. Aaron, but there are some costs there. Whatever the costs are, it looks like it works on paper out through 2075.

Mr. MATSUI. Well, obviously, you haven't gotten it costed-out, though. I mean, this is my problem.

Mr. BEACH. Social Security has costed some of these plans out. As you know, there is——

Mr. MATSUI. What is your plan, the 5 percent——

Mr. BEACH. Well, we don't have one that we have submitted to Social Security, but soon. But they have two plans which they have costed out, and it looks like there is a certain transition cost. But, remember, the current system has a transition cost, too, and it could be $4 trillion. So is it the current system's plan or some other—whatever that number is.

Mr. MATSUI. If I can just suggest this: Maybe what you should do is incorporate your 5 percent, whatever it is, and come up with a plan and let us cost it out for you.

Mr. BEACH. Let me send you the July 1 paper.

Mr. MATSUI. That is the only way we are going to get a comparison, and that is the only way you are going to be fair to everybody. It is unfair to the President to have his plan attacked and then talk anecdotally about what a wonderful idea——

Mr. BEACH. Not anecdotally at all, Mr. Congressman. I have a paper on July 1 that I am going to send you, your staff.

[The following was subsequently received:]

Heritage Foundation Backgrounder No. 1199, July 1, 1998

A NEW FRAMEWORK FOR CUTTING TAXES: REFORMING THE TAX CODE AND IMPROVING SOCIAL SECURITY [1]

Congress appears headed toward a tax bill containing less than $100 billion in tax cuts over five years. The passage by the House in early June of a budget resolution that would return $101 billion in tax revenue to Americans, which followed the Senate's vote to return only $30 billion, sets the stage for one of the most disappointing tax "cut" bills in recent history.

This is discouraging because rarely has there been a better opportunity, or clearer need, to return tax revenues to America's families. Consider:

• Tax revenues are far above the projections made in last year's budget. The Congressional Budget Office (CBO) estimates that the government will take in $340 billion more revenue between fiscal year 1999 and fiscal year 2003 than it forecast as recently as January 1997.[2]

• Federal revenues are expected to consume nearly 21 percent of economic output in 1998, a peacetime record.[3]

• Since Bill Clinton became President in 1993, the tax burden as a proportion of output has risen by nearly two percentage points, equivalent to $157 billion in extra taxes this year. Just reducing taxes to their level at the time President Clinton took office would mean the average family of four would receive more than $1,930 in annual tax relief this year.[4]

• The House-passed tax cut resolution of $101 billion over five years pales in comparison to a tax cut of $1.3 trillion—in terms of today's dollars and gross domestic product (GDP)—proposed by House Democrats in 1981 as an alternative to the Reagan tax cut.

Placed against this context of a rapidly growing federal government that is absorbing hundreds of billions in extra projected taxes, the tax relief proposed even in the current House resolution is puny. It would cut total taxes over five years by just 1 percent, meaning that taxes as a proportion of economic output would fall by just 0.3 percent from their near record level. Only one-fourth of the Treasury's unexpected windfall tax revenue (or only one-third of the projected surplus) will be re-

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[1] The principal authors of the text and policy are William W. Beach, Stuart M. Butler, Gareth G. Davis, Robert Rector, D. Mark Wilson, and John S. Barry (consultant). The Heritage analysts responsible for each major section of this paper are identified in footnotes appended to each of these sections. Other Heritage analysts who contributed to the text and policy recommendations are Angela Antonelli, Rea Hederman, and Daniel J. Mitchell. Statistical analysis supporting this study was provided by the staff of the Center for Data Analysis of The Heritage Foundation: William W. Beach, Ralph A. Rector, D. Mark Wilson, Gareth G. Davis, Rea Hederman, and Phillipe Lacoude.

[2] Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1998–2007 (Washington, D.C.: Congressional Budget Office, 1997), Table 2–3; Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1999–2008 (Washington, D.C.: Congressional Budget Office, 1998), Table 3.1; letter to the Honorable John R. Kasich from June E. O'Neill, Director, Congressional Budget Office, May 6, 1998 (available on the CBO Web page at http://swww.cbo.gov/showdoc.cfm?index=470).

[3] According to the Congressional Budget Office, the tax burden was higher in 1944 (21.3 percent) and 1945 (20.8 percent), when the United States was locked in a two-front global war.

[4] For the 1993 ratio of federal revenue to nominal gross domestic product, see Economic Report of the President, 1998 (Washington, D.C.: U.S. Government Printing Office, 1998), Tables B1 and B78. For the current ratio, see Office of Management and Budget, "FY 1999 Mid-Session Review," 1998, Tables 1 and 2.

turned to taxpayers. And although the House and Senate do plan to take serious action to end the marriage penalty, the level of tax relief they propose will do little or nothing to end pernicious death taxes, cut the tax penalties on savers and investors, ease the burden on families with children, and begin a serious reform of Social Security.

Candidates for office in November who are committed to reducing today's record tax burden and achieving real reform of the tax system should be planning now for a package of tax changes that would attain a level and scope of tax relief that this Congress appears unwilling to propose and the Clinton Administration unwilling to accept. It may be possible to enact some of the necessary measures this year within the framework of the very modest relief that seems likely to be signed into law. Even more important, it is vital for tax reformers to begin now to make the case for tax reductions and reforms that can be enacted next year.

Serious tax reduction must achieve two objectives:

First, it must be on a scale that gives truth to the President's hollow declaration in his 1996 State of the Union Address that "the era of big government is over" (just returning the tax burden to its 1993 proportion of national output would mean a $930 billion tax cut over five years).[5]

Second, it should be designed not to placate particular constituencies, but to end damaging deficiencies in the code that hurt economic growth and to pave the way for fundamental reform of the tax code and Social Security.

Analysts at the Heritage Foundation have crafted just such a tax cut plan that would deliver tax relief to America's families at the same time it promotes job creation and economic growth. The Heritage plan would:

1. Create worker-owned retirement accounts funded by five percentage points of the current payroll tax. Providing Private Savings Accounts would substantially increase the ability of families to save for a better retirement and create wealth that could be passed on to their children.

The five-year diversion of payroll taxes equals $867 billion.

2. Repeal the marriage penalty. Repealing the marriage penalty would assist those families that pay additional taxes because of the way their income is split between the primary and secondary earner.

The five-year tax savings equals $101 billion.

3. Cut the tax on long-term capital gains from 20 percent to 10 percent and repeal the complex "holding" rules enacted last year. Reducing the taxes levied on capital gains would produce an immediate increase in federal revenues and a solid, sustainable boost to the general economy. Lower capital gains taxes encourage large and small investors to move (or unlock) their funds from less productive to more productive companies.

The five-year tax savings equals $6.5 billion with unlocking, and $66.6 billion without it.

4. Expand "back-ended" education IRAs to cover all levels of education, including K–12, and all education savings plans, including those offered by states and private institutions of higher education. This proposal would help the families of approximately 19 million school-age and/or college-bound children.

The five-year tax savings equals $1.4 billion.

5. Modify Section 125. Allow workers in "cafeteria" benefit plans or flexible spending accounts to roll over their own contributions, up to $500, from one year to the next instead of forfeiting unused funds under the current "use-it-or-lose-it" system. This would encourage more prudent use of medical care, as workers would not have to worry about losing money at the end of the year. Even workers not currently enrolled in cafeteria plans would benefit from lower overall costs to the entire health care system.

The five-year tax savings equals $2.1 billion.

6. Repeal the death tax. Taxing the transfer of assets from one generation to the next hurts small businesses, farmers, the self-employed, and others. Federal death taxes are probably the most expensive taxes to pay and to collect. It is estimated that the $20 billion in death taxes collected last year actually cost taxpayers $26 billion.

The five-year tax savings equals $132.3 billion.

7. Provide greater tax relief for families with children below the age of five. Current tax law provides cumbersome, complex, and largely ineffective tax relief to families that need day care for their pre-school children. The Dependent Care Tax Credit should be replaced with a tax credit of $500 per child under the age of five. An estimated 10.7 million children could have been claimed under this credit in 1997.

The five-year tax savings equals $11.1 billion.

[5] See OMB, "FY 1999 Mid-Session Review," Tables 1 and 2.

TOTAL SAVINGS FROM THE TAX PORTION OF THE HERITAGE PLAN = $314.48 billion over five years. Even after this tax cut (which excludes Social Security reform), the federal budget not only remains in balance, but runs a surplus of $30.4 billion over five years.

Full implementation of the Heritage tax plan would produce the following economic benefits:

- The total indebtedness of the government would decline. The "present value" of government obligations is projected to decline by over $15.5 trillion between 1999 and 2075 under the Heritage plan.[6] The long-term unfunded Social Security liability is reduced by approximately $21 billion. Changes in the major components of on-budget spending and revenues account for the remaining decline in government indebtedness.
- Personal savings would increase nearly $1 trillion. Diverting five percentage points of the payroll tax to private investment accounts nearly doubles the personal savings rate between FY 1998 and the end of FY 2003 to 8.9 percent. In fact, the total amount of personal savings rises by $1.1 trillion over this five-year period.
- There would be an average of 451,000 more jobs per year. Repealing the marriage penalty, federal death taxes, and the rollover prohibitions of cafeteria plans, as well as reducing the capital gains tax and creating education IRAs, reduces the taxes on labor income an average 5.8 percent per year from FY 1999 to FY 2003. Lowering the tax costs a worker faces leads some people to find employment and others to increase their hours. The WEFA model forecasts an increase of 552,000 jobs in FY 2001.
- The cost of capital would fall by an average of 5 percent per year. The Heritage tax plan encourages more investment in equipment and factories by reducing the taxes on capital. These lower capital costs stem from repealing the death taxes, which directly tax capital assets, and cutting the capital gains tax rate by 50 percent. The lower capital costs lead to a 24.1 percent increase in investment over five years, which contributes to an increase in worker productivity.
- The economic well-being of succeeding generations would grow dramatically. The Heritage tax plan focuses on building wealth in all households. Low- and moderate-income households benefit substantially from the hundreds of billions in new savings that Social Security privatization creates. Not only will these new savings provide for comfortable retirement in the future, but they also will be used as nest eggs for the children of current savers. For the first time, Social Security payroll taxes will provide the means for passing wealth to the next generation, who in turn will start their working lives with more money for education, health care, and housing than their parents had. Accompanying this significant public policy change with repeal of the federal death taxes assures that the new wealth of American families will be protected from the rapacious tax appetite of the federal government.

THE HERITAGE TAX CUT PLAN

Congress can craft a tax cut plan that delivers significant tax relief to millions of Americans without undermining the integrity of each individual measure. To be sure, this is not the perfect tax cut plan; but given the range of tax proposals that may be possible in this Congress, if tax writers keep in mind a few simple principles, they can craft tax cuts that would benefit families and the U.S. economy:

- Taxpayers must see an immediate benefit from this year's budget agreement. The tax cuts should not be phased in over the next five years in order to reduce their "cost" to the Treasury. Taxpayers should not have to wait until after the turn of the century to see the benefits of this relief.
- The tax package must be a step toward good, long-term tax policy. It should not make the current system more complex and thus undermine the future potential for tax reform. To the extent tax cuts can be implemented, lawmakers should insist that the changes lower marginal tax rates, reduce double taxation, and simplify the tax code.
- The tax cuts must be broad-based and benefit the greatest number of Americans possible. Lawmakers should avoid means-testing or other devices that exclude some families to the benefit of others. Moreover, they should not create special or targeted tax breaks that benefit a select group of individuals or industries at the expense of others.
- The tax cuts must promote good, long-term economic effects. Tax cuts for education, for example, should promote long-term savings rather than subsidize college

[6] "Present value" is an accounting term that measures how much money would need to be invested today to finance future obligations.

fees or encourage more family debt. Subsidizing college fees and debt will boost higher education costs; long-term savings will control higher education costs.

Features of the plan include the following:

1. Empowering Families to Save: Create Private Savings Accounts.[7]

The Social Security system faces two severe crises. First, it faces a funding crisis: The system simply cannot pay promised benefits to future retirees without major changes in the program. Beginning in 2032, if Congress and the Administration do not make changes, it will not be possible to pay full benefits.

In addition, the system will be burdened with the huge costs of the aging baby boomers. If we consider the workers and retirees currently in the Social Security system, the "present value" of the unfunded liability, measured by the amount (in today's dollars) of extra money beyond payroll taxes that would be needed today to pay benefits, would be as much as $9 trillion to $12 trillion.[8] That liability does not appear on the government's books—it is not figured into the official national debt—but, like the national debt, it is money that future taxpayers will have to pay.

Second, Social Security is a terrible way for most Americans to save for their retirement. Although the system currently provides reasonably good benefits for the disabled and the dependents of deceased workers, most workers face their own Social Security crisis because the program typically is a very poor way to save for retirement. Indeed, the retirement income generated from Social Security contributions generally is far below the amount these same contributions would generate in the safest private investments or even in U.S. Treasury bills.

For example, Social Security's inflation-adjusted rate of return is only 1.2 percent for a typical average household of two 30-year-old earners with children, in which each parent makes just under $26,000.[9] Such couples will pay a total of about $320,000 in Social Security taxes over their lifetime (including employer payments) and can expect to receive benefits of about $450,000 (in 1997 dollars, before applicable taxes, after retiring at age 67, the retirement age when they are eligible for full Social Security Old-Age benefits).

Had this average household placed that same amount of lifetime employee and employer tax contributions into conservative tax-deferred IRA-type investments—such as a mutual fund composed of 50 percent U.S. government Treasury bills and 50 percent equities—they could expect a real rate of return of over 5 percent per year prior to the payment of taxes after retirement. In this latter case, the total amount of income accumulated by retirement would equal approximately $975,000 (in 1997 dollars, before applicable taxes).

Social Security needs to be reformed to deal with these twin crises. The reform should do two things: help secure the ability of the system to deliver on its promises to beneficiaries, and enable today's workers to look forward to more income in retirement.

The Heritage Proposal. The Heritage tax plan would achieve both of these goals by allowing—not requiring—workers to place a portion of their payroll taxes now devoted to retirement income (but not disability or other insurance elements) into a private savings account instead.

Workers who exercised this choice would exchange income from their Private Savings Accounts for the Social Security retirement benefits associated with the portion of their taxes they placed in a private account. They would, however, receive the Social Security benefits financed by the rest of their payroll taxes.[10] The insurance elements of Social Security, such as disability and benefits for the dependents of workers who die before retirement, would not be affected, and all Americans, whether or not they opened a private savings account with a portion of their payroll taxes, would be entitled to a minimum benefit from traditional Social Security.

Specifically, every worker would be permitted to divert five percentage points of his or her Social Security payroll tax into a private retirement savings account that met certain federal requirements. General federal revenues would be used to make up the resultant shortfall in trust fund receipts. The reduction in Social Security benefits would be based on the number of years during which the individual elected to place a part of his or her payroll tax in a private account.

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[7] Heritage analysts responsible for this section are Gareth G. Davis, Stuart M. Butler, and Daniel J. Mitchell.

[8] Martin Feldstein, "The Missing Piece in Policy Analysis: Social Security Reform," American Economic Review, Vol. 86, No. 2 (May 1996).

[9] William W. Beach and Gareth G. Davis, "Social Security's Rate of Return," Heritage Foundation Center for Data Analysis Report No. CDA98–01, January 15, 1998.

[10] See Appendix A, Social Security section for details on the benefit reductions and Private Savings Accounts.

While this proposal involves a significant "cost" to the Treasury from the perspective of the annual unified budget accounts, it leads to a reduction in the long-term unfunded liability of the Social Security trust fund. Taken together, the total liabilities of the federal government that will have to be paid by future taxpayers (specifically, the national debt plus the unfunded liabilities of Social Security) would be sharply cut.

Meanwhile, workers could look forward to a higher income during retirement, thanks to the better returns likely to flow from private accounts.[11]

2. Eliminating the Second Earner Bias: Repeal the Marriage Penalty.[12]

In the government's attempt to tax equal-earning couples at the same rate, to incorporate progressive marginal rates, and to enforce marriage neutrality, the federal tax system unintentionally penalizes millions of American families. As the Congressional Budget Office has stated, "The incompatibility of those three goals...results in continuing tension within the tax code."[13]

This tension in the tax code harms the pocketbooks of Americans and the institution of marriage, and has significant implications for the economic and cultural health of our nation. Throughout the tax code, joint filers are repeatedly disadvantaged: Married couples are forced to pay more than they would pay on aggregate as single filers, benefits are consistently lower for married couples in comparison to single individuals, and secondary earners receive lower levels of Social Security benefits than they would have realized had they remained single.

The marriage penalty is arguably the most significant of the secondary earner biases. In short, "the basic source of the marriage tax is the fact that key elements of the tax law depend on an individual's family situation, including the rate schedule, the standard deduction, and the earned income tax credit. Hence, the act of getting married per se affects individuals' tax liabilities, even if their work and saving decisions stay the same."[14]

In most cases, federal income tax laws require that married couples file joint tax returns based on the combined income of husband and wife. When a husband and wife both work, the secondary earner (that person with the lower income) in effect is taxed at the top rate of the primary earner, taxed at the margin. As a consequence, a married couple may pay more taxes than they would if each spouse were taxed as a single.

Unfortunately for the American taxpayer, the federal government has grown dependent on the marriage penalty. The millions of dollars in excess revenues that the government reaps at the expense of married couples has led many to argue preposterously that any significant change in the tax system is impossible because of the potential cost. These revenues do not belong in Washington in the first place, and they must be returned to the taxpayer.

According to the Congressional Budget Office, an estimated 42 percent of married couples incurred marriage penalties in 1996; "more than 21 million married couples paid an average of nearly $1400 in additional taxes in 1996 because they must file jointly."[15] Most severely affected by these marriage penalties were couples with a more equal division of income between husband and wife and those who receive Earned Income Tax Credit (EITC) benefits. Essentially, Americans with the lowest incomes and those families dependent upon two wage earners are the biggest casualties of our current tax policy.

Consider what happens to two $30,000 wage earners who decide to wed. As a single individual, a $30,000 wage earner would pay $3,457.50. The principle of marriage neutrality means that when a $30,000 wage earner marries another $30,000 wage earner, the new tax liability should be $6,915. Under joint filing, however, this married couple, who now earn a combined total of $60,000, are now taxed $7,795 per year; there is, in other words, an $880 penalty for marriage.

According to the ideal of marriage neutrality, tax burdens should not be altered when two people decide to marry. However, the goal of progressive taxation is violated under such circumstances. Progressivity states that a person (or, under today's joint filing, a combination thereof) who has twice the income of another pays more than twice the taxes. The tax system has sided with the ideal of progressive taxation and punished hard-working Americans.

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[11] See Beach and Davis, "Social Security's Rate of Return," Table 1. "Present value" is an accounting term that measures how much money would need to be invested today to finance future obligations.

[12] Heritage analysts responsible for this section include William W. Beach and Rea Hederman.

[13] Congressional Budget Office, For Better or For Worse: Marriage and the Federal Income Tax (Washington, D.C.: U.S. Government Printing Office, June 1997), p. XII.

[14] Daniel R. Feenberg and Harvey S. Rosen, "Recent Developments in the Marriage Tax," National Tax Journal, Vol. 47, No. 1 (March 1995), p. 2.

[15] CBO, For Better or For Worse, p. 1.

The second earner bias, and the marriage penalty specifically, can have significantly negative economic implications for the country as a whole. Not only do these faults of the tax system stand as an obstacle to marriage, but they can discourage husbands or wives from entering the work force. "By adding together husband and wife under the rate schedule, tax laws both encourage families to identify a primary and secondary worker, and then place an extra burden on the secondary worker because her wages come on top of the primary earner's. The secondary earner is on the margin."[16]

As the family realizes lower income levels, the nation realizes lower economic output. From a strictly economic standpoint, for potential workers to avoid the labor force as a result of peculiarities within the tax code is a clear sign of failure to maximize eligible resources. As a result, the nation as a whole fails to reach its potential, demonstrated by decreased earnings, output, and international competitiveness.

The Heritage Proposal. Families with married parents should not be penalized by federal tax policy. The Heritage proposal permits married taxpayers to choose the tax filing status that gives them the lowest tax on the income they earn individually.

This option is available widely in the states: 10 states allow married couples to file separately when paying state income tax; an additional 21 states have rate schedules that reduce or eliminate the marriage penalty.[17]

In nearly half of all married households, such taxpayers will find that filing as single taxpayers will result in lower taxes. Common income (such as interest on a savings account or dividends) would be apportioned between the two taxpayers according to the percentage of total income that each earned from their jobs.

The standard deduction or the itemized deductions would be treated in a similar fashion. These married taxpayers would recombine their income when determining whether or not they are eligible for tax credits.

3. Unlocking Economic Growth: Cut the Capital Gains Tax.[18]

One of the most important things Congress can do this year to spur job and economic growth is to reduce capital gains taxes. Lower capital gains taxes stimulate economic growth by reducing the cost of capital: Taxes make up one part of the cost of capital, and lowering capital taxes reduces the "price" of capital to all kinds of borrowers.

When borrowing costs fall, entrepreneurs create more new businesses, managers of existing businesses expand their factories and buy new machines, and families buy new cars and homes. All of this expansion in economic activity means more jobs and higher worker productivity. Productivity gains that stem from workers using new and improved machines help to increase average wages, thus returning income benefits even to households that may never have capital gains income.

Some Members of Congress still believe that lower taxes on capital gains benefit only rich taxpayers. The data, however, tell a different story. As Table 2 illustrates, nearly 88 percent of all current taxpayers with capital gains declarations on their tax returns have incomes from other sources (such as wages, salaries, self-employment, and pensions) under $100,000; and 55 percent of all capital gains dollars are found in households with incomes below $100,000.

In other words, those taxpayers who would benefit from a 50 percent cut in the capital gains tax rates are likely to be in the middle class.

Just as lawmakers should shun the "tax cuts for the rich" argument, they should reject the counsel of those tax economists who suggest that lowering the effective tax rate on capital will not result in a significant change in capital gains declarations. History suggests otherwise.

Experience with changes in capital gains tax rates over the past 25 years indicates strongly that rate decreases (or exclusions) produce more declarations of capital gains, and thus more capital gains taxes. Owners of appreciated assets who face high tax rates generally hold on to their assets in anticipation of lower future rates. When rates come down, the amount of capital gains taxes goes up. In fact, it appears that last year's reduction in the capital gains tax rate has produced a huge windfall of federal tax revenue.

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[16] Edward J. McCaffery, Taxing Women (Chicago and London: University of Chicago Press, 1997), p. 15.

[17] Ibid., p. 62.

[18] Heritage analyst William W. Beach contributed this section.

Economists estimate that trillions of dollars in unrealized capital gains (perhaps as much as $7.5 trillion) exist in the portfolios of American taxpayers.[19] Some economists have estimated that significant capital gains rate changes could produce substantial economic benefits and create revenue windfalls for federal and state governments.

In a 1994 article for the American Economic Review, Leonard Burman and William Randolph, two leading tax economists on the staff of the Congressional Budget Office, estimated the response of taxpayers to rate reductions as being on the order of 1 to 6 in the short term. This means that for every 1 percent drop in the rate (or the equivalent in exclusions), capital gains realizations would rise by 6 percent.[20]

A 50 percent reduction in the capital gains tax rate, therefore, has the potential of raising declarations by 300 percent. It is from this increase in declarations that the federal government receives capital gains revenues above what it would have received without the 50 percent tax cut.

The Heritage proposal. Congress should cut the tax rates on long-term capital gains from 20 percent to 10 percent, and from 10 percent to 5 percent for lower income tax margins, and repeal the complex "holding" rules enacted last year.

Congress reduced the top capital gains tax rate from 28 percent to 20 percent in the Taxpayer's Relief Act of 1997, which resulted in significant increases in federal revenues as investors sold appreciated assets that the higher tax rate had "locked up." However, at the same time that Congress boosted tax collections and lowered the cost of capital by cutting the top capital gains tax rate, it also passed accounting and tax rules that increased taxpayers costs of complying with capital gain tax law.

The new "holding period" rules are so complex that even the IRS had great difficulty determining how to design the tax form (Schedule D) that taxpayers use when declaring their capital gains; not until late February of 1998 did the IRS issue this important schedule for the 1997 tax year.

By cutting the tax rate by 50 percent, Congress will add new revenues as more taxpayers "unlock" more of their appreciated assets. And by repealing the complex holding period rules, Congress will reduce the cost taxpayers currently face when complying with tax law. Both reforms lead to a fairer, simpler, and flatter tax code.

4. Providing Health Choices for Americans: Allow Workers to Roll Over Flexible Spending Accounts.[21]

Members of Congress have the opportunity to put Americans more in charge of their own health care decisions and to make health insurance and medical services more accessible, more accountable, and more affordable for working families. That opportunity lies in making a slight revision in Section 125 of the Internal Revenue Code, which governs flexible spending accounts (FSAs) and "cafeteria" plans.

These tax-free accounts allow workers to save for unexpected costs of medical services or benefits not covered by their employer-provided health insurance packages. Today, both employers and employees can contribute to FSAs, and the money in these accounts can be used to pay for out-of-pocket medical expenses or for the co-payments and deductibles of their employer-provided packages.

Under the "use-it-or-lose-it rule," however, employees who do not use all of the pre-tax money they set aside each year for medical needs must lose any excess money in the accounts at the end of that year. From the standpoint of cost control, this policy is counterproductive since it creates an incentive for working families to expend all the funds in their FSAs, even if the medical services they purchase are only marginally desirable or beneficial, rather than lose the money entirely.

The Heritage Proposal. Congress could easily correct this flaw by modifying Section 125 to allow workers to roll over up to $500 of unused FSA funds, year after year, tax-free. The immediate results of such a change would be an increase in the direct purchasing of medical services from doctors and other providers, a change in the dynamics of the current insurance market, and an increase in personal savings for future health care spending or retirement.[22]

As more funds are saved through such rollover FSAs or cafeteria plans and are available for retirees' health care coverage, the future demands on Medicare would decline. The change in revenue to the federal Treasury in the meantime, based on

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[19] See, for example, Jude Wanniski's March 15, 1995, testimony before the Senate Finance Committee as cited in Stephen Moore and John Silvia, "The ABCs of the Capital Gains Tax," Cato Institute Policy Analysis No. 242, October 4, 1995.

[20] Leonard E. Burman and William C. Randolph, "Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data," American Economic Review, Vol. 84, No. 4 (September 1994), p. 803.

[21] Heritage analysts responsible for this section include William W. Beach and Gareth G. Davis.

[22] Robert E. Moffit and William W. Beach, "Rollover Flexible Spending Accounts: More Health Choices for Americans," Heritage Foundation Backgrounder No. 1159, February 24, 1998.

Heritage Foundation calculations, would amount only to an average revenue decrease of $482 million per year, or $2.1 billion over five years.

Revising Section 125 of the Internal Revenue Code would result in immediate benefits for a significant portion of the American work force. According to the Bureau of Labor Statistics, as of 1994, 21.7 million private-sector employees chose to take advantage of employee-provided FSAs—14.8 million employed in medium to large establishments and 6.9 million in small establishments. In addition, 50 percent of state and local government employees had FSAs.[23]

Today, FSAs and cafeteria plans are gaining popularity in the marketplace. They have been proven to meet the needs of a diversified pool of workers. If FSA funds can be rolled over tax-free, they will become a great boon, stimulating employee savings and enhancing employee security.

5. Helping Families Afford a Total Quality Education: Expand Education Savings Accounts.[24]

Last year, as part of the Taxpayer's Relief Act of 1997, Congress and the President established education IRAs as a new way for American families to save for their children's college education. As a result of the new law, families with an annual income of less than $110,000 are able to set aside up to $500 in after-tax earnings each year for future college expenses. This money can then be withdrawn to pay for qualified higher education expenses without any further taxes being paid.

With the exception of the income cap on eligible families, education IRAs are sound tax policy (the accounts eliminate the double taxation on savings) and sound education policy (they also encourage savings for college rather than debt).

The rising cost of higher education is one of the major concerns facing American families today. Over the past 18 years, the cost of a college education has increased some 221 percent, while the general rate of inflation and the average household income have increased only about 80 percent.

Furthermore, the cost of college is uncertain, making it difficult for families to anticipate just how much they must put aside or how much debt they or their children will have to incur to pay for a college education. Both the uncertainty and the generally high cost of a college education should be matters of concern to Congress and the President.

The Heritage Proposal. Congress should expand the scope of education savings accounts to cover not only higher education expenses, but also primary and secondary education costs.

Senator Paul Coverdell (R–GA), Senator Robert Torricelli (D–NJ), and House Speaker Newt Gingrich (R–GA) proposed such a sensible approach earlier in the 105th Congress. The measure (H.R. 2646), as passed by both the House of Representatives and the Senate, would expand education IRAs to cover primary and secondary education expenses and would increase the annual contribution limit to $2,000 per student.

Ideally, both the annual contribution limit and income cap should be eliminated. In the end, all families should have the ability to save all that is necessary to secure a quality education for their children from kindergarten through graduate school.

Moreover, the coverage of tax-free education savings should be expanded to include new and innovative education investment plans. Numerous states and several private interests, for example, have established prepaid tuition plans. These programs allow families to lock in future college tuition at or below today's tuition rates.

Such prepaid tuition plans are attractive to families because they guarantee a predetermined amount of future education. Thus, prepaid tuition plans not only help families save for college, but also eliminate the uncertainty of ever-increasing college tuition costs. All of these plans, both public and private, as well as other innovative education investment options, deserve the full support of Congress and the President.

6. Helping Family Businesses and Farms: Repeal the Death Tax.[25]

Death taxes place burdens on those groups in society that current tax policy intends most to help: minority and female business people; farmers; the self-employed; and (indirectly but no less significantly) blue-collar workers, especially those just starting their working careers.

The estate tax hurts small businesses. Investing in a business is one of the many forms of saving—for some families, the only form. For most small firms, every available dollar goes into the family business—the dry cleaning business, the restaurant,

[23] "Talking Points on Section 125," Employers Council for Flexible Compensation, Washington, D.C., 1997.

[24] John Barry, a consultant, contributed this section.

[25] William W. Beach is responsible for this section.

the trucking company—because the business creates an asset for the children and income for the owners. Women re-entering the work force after raising children often find self-employment the only employment open to them. Minorities also rely heavily on self-employment.

All of the financial security provided by these businesses is put at risk if the owner dies with a taxable estate. In an important 1995 study of how minority businesses perceive the estate tax,[26] Joseph Astrachan and Craig Aronoff found that:

- Some 90 percent of the surveyed minority businesses knew that they might be subject to the federal estate tax;
- About 67 percent of these businesses had taken steps (including gifts of stock, ownership restructuring, life insurance purchases, and buy/sell agreements) to shelter their assets from taxation;
- Over 50 percent of these same businesses indicated that they would not have taken these steps had there been no estate tax; and
- Some 58 percent of all businesses in the survey anticipated failure or great difficulty surviving after determining their estate taxes.

Death taxes are, in a real sense, more "affordable" as income rises. In other words, what appears to be a progressive tax contains a regressive dimension.

Students of the estate tax are continually struck by the frequency with which taxpayers are insufficiently prepared to pay the tax, and nearly as frequently by the correspondence between those unprepared and those who have not had the benefit of high-priced legal and accounting advice. Indeed, legal avoidance of high death-tax liabilities is closely related to the fees taxpayers can pay throughout their lives for expensive tax-planning advice. Taxpayers who cannot pay these tax-planning fees end up paying high estate taxes.

Not only do death taxes reduce potential employment and undermine the promise that hard, honest work will be rewarded, but they also reward consumption and undermine saving. What can be said generally about income taxes can be emphatically affirmed about death taxes: Accumulation of even modest wealth will lead to heavy taxes, while consumption of income results in relatively light taxation.

In other words, it makes tax-planning sense to buy vacations in Aspen or a painting by Rubens rather than invest in new productive equipment and new factories.

Federal death taxes are probably the most expensive taxes to pay and to collect. Death taxes raise just a bit more than 1 percent of total federal revenues, but they are amazingly expensive for the taxpayer and the tax collector.

Christopher Erblich places total compliance costs (including economic disincentives) at 65 cents for every dollar collected. Other studies that subtract disincentives and examine only direct outlays by taxpayers to comply with estate tax law put compliance costs at about 31 cents.[27] This additional cost of compliance means that the $20 billion collected in federal death taxes last year actually cost taxpayers $26 billion.

The Heritage Proposal. Congress should repeal the death tax. The economic effects of the disincentive to savings and investment are quite striking, especially in light of the relatively small amounts of federal revenue raised by federal death taxes.

An analysis by The Heritage Foundation, using the WEFA Group's U.S. Macroeconomic Model, found that repealing the estate tax would have a large and beneficial effect on the economy.[28] Specifically, the Heritage analysis found that if the tax were repealed this year, over the next nine years:

- The nation's economy would average as much as $11 billion per year in extra output;
- An average of 145,000 additional new jobs could be created;
- Personal income could rise by an average of $8 billion per year above current projections; and
- The deficit actually would decline, since revenues generated by extra growth would more than compensate for the meager revenues currently raised by the inefficient estate tax.

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[26] Joseph H. Astrachan and Craig E. Aronoff, "A Report on the Impact of the Federal Estate Tax: A Study of Two Industry Groups," Family Enterprise Center of the Coles School of Business, Kennesaw State College, July 24, 1995.

[27] For a review of this literature, see Richard F. Fullenbaum and Mariana A. McNeill, "The Effects of the Federal Estate and Gift Tax on the Aggregate Economy," Research Institute for Small and Emerging Business Working Paper Series 98–01, 1998, p. A–2.

[28] See William W. Beach, "The Case for Repealing the Estate Tax," Heritage Foundation Backgrounder No. 1091, August 21, 1996.

Richard Fullenbaum and Mariana McNeill recently confirmed these results in an important study for the Research Institute for Small and Emerging Business.[29] In a simulation of estate tax repeal using the WEFA U.S. Macroeconomic Model, they found that private investment would rise by an average of $11 billion over the seven years following repeal. Consumption expenditures would rise by an average of $17 billion (after inflation), and an average of 153,000 new jobs would be created in this more buoyant economy.[30]

7. Helping Families Care for Their Children: Create a Parental Care Preschooler Tax Credit.[31]

During the baby-boom era, when most of today's parents were born, the federal government had a deliberately low-tax policy which was friendly to families and children. But that family-friendly policy has long since disappeared.

In 1950, the typical family of four paid about 5 percent of its income in taxes to the federal government. Today, that same family would pay roughly 23 percent of its income in direct federal taxes. Adding state, local, and indirect taxes raises the tax bite typically to about 37 percent. This means that in the average two-earner married-couple family, the mother works not to raise her family's standard of living, but primarily to pay for the enormous tax increases imposed by decades of government spending.

Studies show that many parents would prefer to work less and spend more time with their children. But with today's record peacetime levels of taxation, many mothers feel compelled to enter the work force.

Working mothers with young children, particularly preschool children, commonly pay for some child-care services. Combined with the impact of the marriage penalty, this means that a mother can work full-time and yet add only a few dollars to the family's net monthly income. If, on the other hand, the mother stays at home to care for her children, leaving the husband as the only earner, the family does not receive the dependent care tax relief available to mothers who work outside the home.

President Clinton proposes to "solve" this problem with new subsidies for day care. The Clinton proposal targets over $20 billion of the projected budget surplus on one kind of service: the care of children outside of the family environment and away from parents. In addition to providing tax relief to middle-class parents who use day care, Clinton is proposing billions in new government day-care spending through such programs as the Child Care and Child Development Block Grant and Head Start. Two-thirds of the funds under the Clinton plan is allocated to new government spending, not tax reduction.

Thus under Clinton's plan, middle-class parents who hire others to care for their children will receive some help for their day-care costs, but parents who make a great financial sacrifice so that one parent can remain at home to care for their young children will receive neither assistance nor tax relief. Indeed, families who care for their own children will be taxed to pay for day care used by typically more affluent families.

To deal with the burden of excessive taxes on families with children, Congress should provide tax relief to parents, not new spending directed to day-care centers. In providing that tax relief, Congress should allow parents to decide how best to care for their children; it should aim to expand rather than narrow their options.

Furthermore, Congress should treat all working families with preschool children equally. Under no circumstances should it discriminate against families who make a financial sacrifice so that one parent can remain at home (either full-time or part-time). Nor should paid professional day care be favored over the unpaid care given by the children's grandparents.

Congress took a small step last year toward rolling back the punitive taxation of families with children by enacting a tax credit for children under the age of 18. The credit will be worth $400 per child in 1998 and $500 in each subsequent year. Congress should build on this foundation by providing additional badly needed tax relief to working families with preschool children.

The Heritage Proposal. Current law provides a cumbersome and complex system of tax relief for second-earner mothers working outside the home who use child care services. Under the Heritage proposal, this Dependent Care Tax Credit would be replaced with a new $500 tax credit per preschool child. This would be in addition to the credit enacted last year, and the credit would not be refundable.

In other words, the total credit available would be limited to the amount that otherwise would be paid by the family in income tax—it could not be claimed against

[29] See Fullenbaum and McNeill, "The Effects of the Federal Estate and Gift Tax on the Aggregate Economy," esp. pp. 11–15.

[30] Ibid., p. 15.

[31] The Heritage analyst responsible for this section is Robert Rector.

Social Security payroll taxes and would be calculated after the Earned Income Tax Credit had been computed.

HOW THE HERITAGE PLAN WOULD BENEFIT JOBS AND THE ECONOMY [32]

The Heritage Foundation tax cut plan promotes job creation and economic growth while delivering substantial tax relief to American families over the next five years. The plan also promotes significant increases in private savings devoted to retirement.

- Over 70 percent of the $1,104.6 billion in total tax cuts goes to help families save for a better retirement.
- Another 18 percent would be used to reduce the high taxes imposed on families who try to pass down their life's work to their children and to reduce the tax penalties on savings and investment.
- The remaining 10.4 percent would flow to American families to eliminate the marriage penalty and promote savings for their children's education, the out-of-pocket medical expenses that are not covered by insurance, and the additional child credit.

Heritage Foundation economists analyzed the tax cut plan's impact on jobs and economic growth using the January 1998 U.S. Macroeconomic Model of the WEFA Group. WEFA economists reconstructed their January model for The Heritage Foundation to embody CBO economic and budgetary assumptions published by the CBO in January of this year.[33] Thus, it is fair to say that simulations of policy changes using this specifically adapted model produce dynamic results based on CBO assumptions.

Next, the elements of the Heritage tax plan were entered into the model to simulate the plan's dynamic economic impacts. See Appendix A for a description of how elements of the Heritage tax plan were incorporated into this adapted version of the WEFA U.S. Macroeconomic Model.

The Heritage analysis using the WEFA model indicates that a balanced package of tax cuts to help families and encourage investment will result in a stronger, more vigorous general economy over the five-year period between FY 1999 and FY 2003 (see Appendix B). This analysis suggests that the Heritage tax cut plan would:

- Increase real GDP. The Heritage tax plan increases the real gross domestic product by $50.2 billion in FY 2003. Despite this increase in economic growth, inflation, as measured by the Consumer Price Index, remains a low 2.7 percent. The model also indicates that the increases in output are due in part to real growth in productivity. The rate of growth in productivity increases 0.3 percentage points in FY 1999 and 0.1 percentage points in FY 2001, which is a significant expansion for an economy currently operating at near-capacity levels.
- Increase average household income over $2,280. The Heritage tax plan produces $248.7 billion in additional, inflation-adjusted disposable income for households in FY 2003—equal to $2,288 in higher income for the average American household. Almost 92 percent of this increase flows directly into Private Savings Accounts.
- Increase household savings and investment. Personal saving increases by $229.2 billion and inflation-adjusted investment rises by $18.1 billion in FY 2003. This private-sector saving and investment will improve the productive capacity of the U.S. economy and the standard of living for future generations.
- Spur job creation. Repealing the marriage penalty and death taxes and reducing the capital gains tax rewards work and promotes economic growth. The Heritage tax plan produces an average of 451,000 more jobs per year over the five-year period. In fact, in FY 2001, the simulation shows that the private sector produces 552,000 more jobs. The average unemployment rate is lower under the Heritage plan than in the baseline economy.
- Produce economic "feedback." Using mostly "static" estimates that take only limited account of the tax cut's influence on the economy's performance, the Heritage tax plan would reduce revenues to the federal Treasury by $313.6 billion over five years (excluding Social Security reform). The more "dynamic" analysis using the WEFA model, however, suggests that because the tax cut plan promotes stronger economic growth, the expanding tax base feeds new tax revenues back into the fed-

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[32] Heritage analysts responsible for this section are D. Mark Wilson and William W. Beach.

[33] See Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1998–2008. See also the Appendix A for a description of The Heritage Foundation's use of the WEFA Model and various steps incorporated to simulate the budget resolution. It should be noted that the methodologies, assumptions, conclusions, and opinions herein are entirely those of Heritage Foundation economists and have not been endorsed by, and do not necessarily reflect the views of, the owners of the WEFA U.S. Macroeconomic model.

eral Treasury. These new tax revenues replace or “feed back” 23.3 percent of the expected revenues lost to the Treasury under a static analysis.

In other words, when the tax cut plan’s effect on economic performance is accounted for, the actual “cost” of the plan to the Treasury is only 76.7 percent of the purely static reduction in tax revenues over five years. This revenue feedback, when combined with the tax plan’s impact on federal spending and the effect of slightly lower Old-Age and Survivors Disability Insurance (OASDI) benefit payments, increases the overall feedback effect on the federal deficit to 38.3 percent over five years.

CONCLUSION

This Congress, like the one elected in 1994, is pledged to reduce taxes and spending. And President Clinton, according to his own pledge, is committed to ending the era of big government. But while Congress has enacted tax relief and ended programs, government continues to grow.

More specifically, major spending control exists only on paper—with the hard decisions on how to meet the targets put off until future years—and the tax cuts enacted since the beginning of 1995 have placed only a mild restraint on the growth of taxes. This year, the federal government will take in an estimated $1.7 trillion, equivalent to roughly $17,000 in taxes for the average family. Americans are now paying a higher proportion of their national income than at any time since the last years of World War II. Moreover, Americans are now paying far more in taxes than Congress intended, with the Congressional Budget Office forecasting hundreds of billions of dollars in unanticipated taxes flowing to Washington over the next five years.

If taxpayers discover they have paid too much in tax when they file their tax returns on April 15, they know they are entitled to a refund. Congress should be honoring that normal principle of taxation and returning extra taxes to the taxpayers. But a majority of Members of Congress evidently are unwilling to do that, as is the Clinton Administration. Nor is Congress willing this year to take the serious steps needed to reform the tax system and Social Security that can be achieved with today’s strong economy and surging tax revenues.

But even if perceived political constraints prevent Congress this year from significantly reforming and reducing the share of family budgets that go to the federal government, now is the time to construct a framework for serious action. This framework should be discussed with the American people this November and in Congress next year.

Analysts at The Heritage Foundation have developed such a framework. It would sharply reduce income taxes, earmarking over two-thirds of the projected surplus to income tax relief—doing so in ways that would encourage saving and end today’s bias against marriage and child-rearing. And it would take a large step toward reforming Social Security by giving workers the right to devote part of their payroll taxes to a private savings account—doing so in a way that would significantly cut the total liabilities of the federal government.

The principal authors of this study are William W. Beach, Director of the Center for Data Analysis; Stuart M. Butler, Vice President for Domestic and Economic Policy Studies; Gareth G. Davis, Research Assistant in the Center for Data Analysis; Robert Rector, Senior Policy Analyst for Welfare and Family Issues; D. Mark Wilson, Labor Economist in the Center for Data Analysis; and John S. Barry, consultant to The Heritage Foundation.

Other Heritage analysts who contributed to the text and policy recommendations are: Angela Antonelli, Director of the Thomas A. Roe Institute for Economic Policy Studies; Rea Hederman, Research Analyst in the Center for Data Analysis; and Daniel J. Mitchell, McKenna Senior Fellow in Economics.

Statistical Analysis supporting this study was provided by the staff of the Center for Data Analysis: William W. Beach; Ralph A. Rector, Project Manager; Gareth Davis; Rea Hederman; Phillipe Lacoude, intern; and D. Mark Wilson.

APPENDIX A: METHODOLOGY[34]

Heritage economists follow a two-step procedure in analyzing the revenue and economic effects of proposed policy changes.

First, estimates are prepared of revenue changes that stem from changes in the taxpaying population eligible for the tax change, from the base of taxable income absent any change in the economy, and from the tax rates. These estimates frequently are called "static" estimates, largely because they are unaffected by changes in the behavior of taxpayers that stem from tax policy reforms.

Second, these static revenue changes and other important modifications of tax law are introduced into the WEFA U.S. Macroeconomic Model. The WEFA model has been designed in part to estimate how the general economy is reshaped by policy reforms. The results of simulations performed in the WEFA model produce the "dynamic responses" to policy changes.

The following sections describe how Heritage economists prepared the static estimates described in the paper and how these results and other assumptions were introduced into the WEFA model.

THE REVENUE AND OUTLAY BASELINE

Heritage analysts revised the five-year revenue and expenditure forecasts of the Congressional Budget Office that were issued on March 3, 1998. These revisions first accounted for additional FY 1998 and FY 1999 revenues announced by the CBO in a May 5, 1998, letter to John Kasich (R–OH), chairman of the House Budget Committee.

Second, Heritage extended the CBO's forecast of higher revenues for FY 1998 and FY 1999 to fiscal years 2000 through 2003. Minor changes were made in the CBO expenditure forecasts to reflect smaller outlays due, among other things, to slower than expected inflation. The year-over-year change rates in the Heritage revenue forecasts follow forecasted growth rates in WEFA's income tax base.

It is worth noting that these adjustments resulted in a five-year cumulative surplus that is $70 billion above the CBO's cumulative surplus and $152 billion below the amount forecasted by the Office of Management and Budget in its FY 1999 Mid-Session Review.

TAX POLICY ASSUMPTIONS

Social Security

Heritage analysts used the Center for Data Analysis Social Security Revenue and Expenditure Model to estimate the net effect on the federal government's liabilities of a 5.0 percentage point carve-out of Old-Age and Survivors Insurance taxes that is coupled with a proportional reduction in future benefit payments.[35]

Under the Heritage proposal, workers between 20 and 61 years of age can choose to divert 5.0 percentage points of their payroll taxes into a Private Savings Account. For each year they divert their taxes, participants lose 2.44 percent (or 1⁄41) of Old-Age and Survivors Insurance benefits that are payable after they reach age 62. Entitlement to pre-retirement Survivors Insurance, Disability Insurance, and any benefits payable to children of deceased workers are not affected by participation.

This policy change was introduced into the WEFA U.S. Macroeconomic Model by reducing the OASDI payroll tax rate by 5.0 percentage points and constraining the model to devote the resulting increase in disposable personal income to savings. OASDI transfer payments were also reduced by a small amount to reflect the decline in OASDI benefit payments for workers with Private Savings Accounts. Finally, tax revenues on a Unified Budget basis were increased by $14.6 billion for FY 1999 to FY 2003 to reflect the distribution of the FY 1998 surplus.

The net effect of this proposal on the present value of federal liabilities is estimated using the baseline contained in the Congressional Budget Office's May 1998 Long-Term Budgetary Pressures and Policy Options. Heritage analysts used the elasticities contained in Section II G to adjust the intermediate projections of the 1998 Report of the Trustees of the Federal Old-Age and Survivors and Disability

[34] Inquiries concerning matters covered in this section should be addressed to Ralph A. Rector, Project Manager for the Center for Data Analysis.

[35] For a description of the model, see Center for Data Analysis Social Security Revenue and Expenditure Model working paper, available upon request.

Insurance Trust Funds so that they conformed with the economic assumptions contained in the CBO's baseline.

The CBO projection assumes a long-term growth in total factor productivity consistent with that actually experienced during the post-war period. This was interpreted to imply a rate of real wage growth consistent with the historical wage growth experienced over this period, and the Trustees' projected long-term annual growth rate of real wages was adjusted from 0.9 percent to 1.4 percent. Analysts also altered the Trustees' inflation and GDP assumptions to match those projected by the CBO. However, Heritage analysts adopted the Trustees' population forecasts.

The CBO's projection of implied interest rates on the national debt shows a slow increase for the next 20 years followed by a rapid increase over the following 30 years, with rates over 9 percent by the year 2050. Sustained interest rates at this level have a profound effect on the overall level of debt. For example, holding the CBO's interest rates and debt growth rates constant past 2050 results in estimated payments on the national debt that exceed the entire GDP in 2075. The imbalance between interest payments and the economy as a whole is caused, in part, by applying a long-term trend even when debt reaches very high levels. A simple but accurate way to address this problem is to use a logistic differential equation in which interest rates asymptotically approach a limit value as the debt increases. Using this approach and an assumed maximum interest rate of 7 percent, Heritage analysts fitted a logistic curve based on a sensitivity analysis performed on the WEFA model. Both the CBO baseline forecast and the Heritage Foundation forecast were adjusted using this method of calculating interest payments.

Heritage analysts projected the net present value effect on the future liabilities of the federal government from reductions in payroll tax receipts and Social Security benefits. A nominal discount rate of 5.3 percent was used to value these amounts. This discount rate is based on the Social Security Trustees' long-term real interest rate projection of 2.8 percent. The Heritage nominal rate also reflects the CBO's projected long-term inflation rate of 2.5 percent. In line with the practice of the Social Security Administration's Office of the Chief Actuary, a participation rate of 100 percent in the private retirement account was assumed.[36]

Marriage Penalty Provisions

Heritage analysts used revenue estimates for marriage penalty repeal prepared by the staff of the Joint Committee on Taxation (JCT) for H.R. 2456 (105th Congress, 2nd Session).[37] This legislation would permit a married taxpayer to choose the filing status (married or single) that produces the least amount of tax liability. The legislation also states rules for allocating joint income, deductions, and exemptions between married taxpayers. Heritage also used data relating to this form of marriage penalty repeal contained in the CBO's review of marriage penalties and bonuses, For Better or for Worse: Marriage and the Federal Income Tax. This report provides estimates of the level of marriage penalty and the amount of change in tax liabilities stemming from correcting the second-earner bias in a manner similar to that described in H.R. 2456.

The purely static revenue loss estimated by the JCT staff was introduced into the WEFA U.S. Macroeconomic Model as a proportional change in average effective personal income tax rate.

Capital Gains Provisions

The Heritage Foundation's estimate of the reduced capital gains tax revenues from individuals is based on data from the 1993 IRS Statistics of Income and revenue forecasts from the Heritage Foundation Individual Income Tax Model. Heritage analysts selected only those tax returns that contained taxable capital gains in 1993, subtracted the amount of these gains from the taxpayer's adjusted gross income, and created a new income variable that summed all of the taxpayer's income except capital gains income. Forecasts of capital gains declarations under current law were made that assumed an annual growth in the base of 4 percent and a real tax rate elasticity of -0.43 percent. These forecasted declarations and associated capital gains taxes were distributed across the new income variable.

[36] A preliminary analysis indicated that while lower rates of participation may have some effect on the magnitude of the net change in long-term federal liabilities, they do not appear to affect the direction of this change.

[37] This legislation was co-sponsored by Representatives David McIntosh (R–IN) and Gerald Weller (R–IL). For JCT's revenue estimates, see letter to the Honorable Jerry Weller from Lindy L. Paull, Chief of Staff, Joint Committee on Taxation. Contact the Center for Data Analysis for a copy of this letter.

These baseline capital gains taxes were reduced by 50 percent to reflect a drop in the long-term tax rate from 20 percent to 10 percent. These reductions were designated the "purely static" revenue losses under this provision. To calculate the changes in revenues under an assumption of "unlocking," Heritage economists assumed a transitory elasticity of −5.0 percent and −3.0 percent, respectively, for years one and two of the tax plan; a permanent elasticity of −1.8 percent was assumed for years after the second year. The application of these elasticities to the base of capital gains declarations significantly decreased the purely static revenue losses. The difference between these purely static revenue losses and the revenues stemming from "unlocking' were introduced to the WEFA U.S. Macroeconomic Model as a proportional change in the average effective personal income tax rate.

Estate and Gift Tax Provisions

Heritage Foundation estimates of the static revenue impact of the increase in the unified credit and the introduction of a family-owned business exclusion are based on data from the JCT summary of estate and gift taxes prepared for the House Ways and Means Committee hearing on January 28, 1998.[38] Additional data were drawn from 1993 IRS Statistics of Income and revenue forecasts based on these and JCT data produced by the Heritage Foundation Estate and Gift Tax Model. Heritage forecasts of estate tax revenues for fiscal years 1999 to 2003 were distributed across adjusted gross income following the techniques described by Daniel Feenberg, Andrew Mitrusi, and James Poterba in "Distributional Effects of Adopting a National Retail Sales Tax," Tax Policy and the Economy, Conference Report, National Bureau of Economic Research, September 1996, pp. 20–22. The purely static revenue loss was introduced into the WEFA U.S. Macroeconomic Model as a proportional change in average effective personal income tax rate.

Educational IRA Provisions

The Heritage Foundation's estimates of the static revenue impact of the educational IRA provisions in this plan are based directly on the amounts estimated by the JCT. The purely static revenue loss was introduced into the WEFA U.S. Macroeconomic Model as a proportional change in average effective personal income tax rate.

Section 125 Rollover Provisions

For the data in Table 1, Heritage economists estimated annual revenue changes stemming from Section 125 reform by constructing a model based on publicly available data and technically derived tax rate and program participation assumptions. Heritage used data on worker participation in flexible saving account plans published by the Bureau of Labor Statistics. The Bureau's Earnings and Employment Reports for 1993 and 1994 contain participation data for small, medium, and large private firms. These estimates were confirmed by survey data developed in 1997 by Hewitt Associates, a national benefits consulting company. Heritage calculated a weighted midpoint participation rate of 20 percent and applied this percentage against an estimate of total establishment payroll employment for 1998. This employment estimate total (123,859,000 establishment employees) was taken from a forecast produced by WEFA, Inc., and is available upon request from the Center for Data Analysis at The Heritage Foundation. The participation rate estimates from Hewitt Associates also are available upon request.

The average annual amount of flexible saving account health care coverage purchased by participating workers ($744) comes from studies prepared by the General Accounting Office in 1988, 1990, and 1992. Heritage analysts confirmed these estimates by comparing them with an estimate of average participation produced by Hewitt Associates for 1997. Heritage assumed that the rollover provision would lead participating workers to purchase an additional $89 in annual health care coverage and capped the maximum amount of the rollover at $500 per worker. Assuming this additional purchase raises the level of revenue decreases from the policy change. Average effective tax rates were derived from data contained in the IRS Public Use File for 1994.

Heritage's estimates for fiscal year 1998 were projected forward into fiscal years 1999 through 2003 by a formula that contains annual estimates of price changes and employment growth among participating employees. All values in Table 1 are expressed in nominal or current millions of dollars.

[38] See Joint Committee on Taxation, "JCT Description of Present Law and Background on Estate and Gift Taxes (JCX–2–98) for Ways and Means Committee Hearing Jan. 28, 1998," printed in Bureau of National Affairs, Daily Tax Report No. 18, 1998, pp. L–11 through L–22.

The purely static revenue loss was introduced into the WEFA U.S. Macroeconomic Model as a proportional change in average effective personal income tax rate.

Under-Five Child Credit

The Heritage Foundation's static revenue estimate of the new tax credit for children under five years of age was calculated from the 1997 March Current Population Survey and the 1994 IRS Public Use File. Taxpayers would be eligible to claim the credit if they had federal tax liability after deducting the 1997 Child Tax Credit and the Earned Income Tax Credit. The credit is $500 per child under the age of five for all taxpayers who qualify and is non-refundable. The projected number of children under the age of five was taken from the Bureau of the Census Middle Series Projections. The average value of the credit per child was assumed to increase in pace with inflation each year up to a maximum of $500. The total value of the credit is offset by the elimination of the Dependent Care Tax Credit.

MODEL SIMULATION ASSUMPTIONS

The WEFA January 1998 CBO Baseline model was initially modified to reflect current law.[39]

Social Security Reform

Heritage economists decreased the Social Security payroll tax by 5.0 percentage points and constrained the WEFA model to devote this tax cut to private saving. The loss in payroll tax revenue was made up with increased government borrowing and a net increase in government debt. OASDI transfer payments were also reduced by a small amount to reflect the decline in OASDI benefit payments for workers with Private Savings Accounts. Finally, tax revenues on a Unified Budget basis were increased by $14.6 billion for FY 1999 to FY 2003 to reflect the distribution of the FY 1998 surplus.

Average Effective Tax Rate

The WEFA model contains a variable that measures the total amount of all federal taxes on individual income as a percentage of nominal personal income. Heritage adjusted this average effective tax rate downward for each of the forecast years to reflect the purely static revenue decreases resulting from adoption of the Heritage tax plan.

Monetary Policy

The model assumes that the Federal Reserve Board will react to these policy changes. This assumption was embodied in our simulation by including the stochastic equation for monetary reserves.

Labor Force Participation and Average Weekly Hours

A small adjustment of 0.18 index points was made in the model's labor force participation rate to account for the dynamic effects of repealing the marriage penalty and the estate and gift tax, as well as reducing the capital gains tax. A small adjustment was also made in average weekly hours to account for the dynamic effects of repealing the marriage penalty. These adjustments in the labor force participation rate and average weekly hours are based on previous research by Heritage economists and the Congressional Budget Office study "Labor Supply and Taxes," January 1996.

Declarations of Capital Gains

Heritage economists adjusted federal tax collections to reflect a higher level of capital gains declarations. The base was increased to reflect estimated elasticities associated with significant capital gains rate reductions.[40]

Corporate AAA Bond Rates

Heritage economists decreased the corporate AAA bond rate by 50 basis points to reflect the drop in taxes on capital stemming from capital gains and estate tax re-

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[39] The January 1998 CBO Baseline model originally had the Social Security payroll tax increasing from 6.2 percent in 2005 to 6.48 percent in 2008; the Medicare payroll tax increasing from 1.45 percent in 2003 to 1.63 percent in 2008; and the minimum wage increasing from $5.15 in 1999 to $6.15 in 2003. These policy assumptions were removed from the model, creating a corrected baseline forecast.

[40] See Burman and Randolph, "Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data."

form. This variable is a component in a large WEFA equation that calculates the cost of capital.

Business Sector Price Index

Heritage economists decreased the business sector price index by an average of 0.25 points to reflect the lower compliance costs associated with the repeal of the estate tax. With repeal comes less reliance on accountants and lawyers to comply with estate and gift tax law. Experts on estate tax compliance have estimated that current compliance costs equal 31 percent of total taxes collected.[41] This variable is a component in a large WEFA equation that calculates the cost of capital.

MEASURING THE HERITAGE PLAN

Heritage economists employed the most current and extensive data available to estimate the effects of these policy changes. Analysts constructed each of the revenue estimates shown in Table 1 from data contained in the Bureau of the Census Current Population Survey for 1997 and the Internal Revenue Service (IRS) Public Use Files for 1993 and 1994.

The annual Current Population Survey represents the largest regularly produced collection of demographic data available to the general policy community. The IRS Public Use File is the largest machine-readable sample of individual income tax returns available. Both databases contain tens of thousands of observations selected by the Census or the IRS using stratified random sampling techniques, and each database is the most accurate source available for variables used in this Heritage tax analysis.

The dynamic analyses were conducted using the WEFA Group's Mark 11 economic model specially modified for The Heritage Foundation by the economists at WEFA to reflect the economic and budgetary assumptions of the Congressional Budget Office, announced by the CBO in January 1998.[1]

In scoring the Social Security reform proposal, Heritage analysts used the latest projections from the 1998 Report of the Trustees of the Federal Old-Age and Survivors and Disability Insurance Trust Funds. In all cases, the intermediate projections, which constitute the Trustees' "best guess" of future demographic and economic conditions, were used.

Heritage economists also used special unpublished population projections in creating the 1998 Trustees' Report, which were made available by the Social Security Administration's Office of the Chief Actuary.

THE MARRIAGE PENALTY: STRUGGLING MIDDLE-INCOME COUPLES ARE HIT HARD.

Take, for example, a family in which the husband, Paul, earns $60,000 annually. Paul's first $16,000 of income goes untaxed under the modern-style married tax rate schedule; earnings from $16,001–$42,350 are taxed at a 15 percent rate; and earnings from $42,351–$102,300 are taxed at a 28 percent rate.

With two young children, Paul's wife Sara seriously considers joining the labor force. Unfortunately for Sara and her family, because of the secondary earner bias, her first dollar of income will be taxed immediately at a 28 percent rate. Even if Sara accepts a job that pays only $30,000—half of what her husband makes—she will end up paying $8,400 in taxes, just below her husband's burden of $11,290. With increased child care costs and work expenses, what appeared to have increased the family's income to $90,000 now looks like a wash.

With reference to women in Sara's situation, the Congressional Budget Office has said, "The higher initial tax rate she faces when married reduces the value of her work and thus may induce her to work fewer hours each week, fewer weeks each

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[41] Fullenbaum and McNeill, "The Effects of the Federal Estate and Gift Tax on the Aggregate Economy," p. A–2.

[1] The WEFA Group's Mark 11 U.S. Macroeconomic Model was developed in the late 1960s by Nobel Prize-winning economist Lawrence Klein and several of his colleagues at the University of Pennsylvania's Wharton School of Business. It is widely used by Fortune 500 companies and by prominent federal agencies and economic forecasting departments. It should be noted that nothing contained in this paper has been endorsed by WEFA, Inc.

year, or even not to work at all."[1] Inherently, Sara's decision to work less or avoid the workforce entirely affects both her family and the national economy.

The CBO went on to say that "generally higher tax rates for lower-earning spouses prompt them to work between 4 percent and 7 percent less than they would if they could file individually. Overall, requiring couples to file joint tax returns induces them to work less. As a result, their total earnings are between 0.7 percent and 1.2 percent less than they would otherwise be."[2]

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Table 1 B 1199

How the Heritage Tax Plan Would Affect the Annual Budget and Long-Term Obligations of the Federal Government

	1998	Impact on Federal Budget, FY 1999–2003 (Billions of Current Dollars) 1999	2000	2001	2002	2003	Total FY1999–FY2003	Reduction/Increase (-) to Long-Term Obligations FY 1999–2075 (Present Values* in Billions of Dollars)
Budget Assumptions								
Baseline Revenue Forecast	1,725	1,807	1,825	1,865	1,928	2,060	**9,485**	
Baseline Outlays Forecast	1,652	1,720	1,777	1,830	1,861	1,953	**9,141**	
Net Surplus	73	87	48	35	67	107	**344**	
Tax Policy Recommendations								
A. Reform Social Security								
1) Private Social Security Investment Accounts								
a) 1998 Surplus Distributed Over Five Years		14.60	14.60	14.60	14.60	14.60	**73.00**	
b) Five Percentage Points of Payroll Tax to Private Accounts		-133.55	-172.08	-179.22	-187.14	-195.05	**-867.04**	**-6,163.87**
c) Social Security Retirement Benefits Offset by Private Accounts		0.00	0.10	0.37	0.88	1.71	**3.06**	**6,185.30**
Subtotal		-118.95	-157.38	-164.25	-171.66	-178.74	**-790.98**	**21.43**
B. Reform the Tax Code								
2) Marriage Penalty Repeal		-12.50	-21.20	-21.90	-22.50	-22.90	**-101.00**	
3) Reduce Capital Gains Tax Rate (Excludes Unlocking Effect)		-12.60	-12.70	-13.10	-13.50	-14.70	**-66.60**	
4) Create Education IRAs		-0.06	-0.20	-0.29	-0.39	-0.47	**-1.40**	
5) Reform Section 125 Rollover Provisions		-0.16	-0.46	-0.47	-0.49	-0.51	**-2.09**	
6) Repeal Death Taxes		-23.90	-24.80	-26.40	-27.70	-29.50	**-132.30**	
7) Tax Policy Changes to Enhance Child Care								
a) Repeal Dependent Care Tax Credit		2.50	2.50	2.50	2.49	2.49	**12.48**	
b) Enact a $500 per Child Credit for Children Under Five Years of Age		-4.74	-4.72	-4.71	-4.70	-4.69	**-23.57**	
Subtotal		-51.46	-61.58	-64.38	-66.79	-70.29	**-314.48**	
Total Social Security and Income Tax Changes		-170.41	-218.96	-228.63	-238.45	-249.03	**-1,105.46**	**15,574.65**
Net Surplus/Deficit (-) After Tax Policy Changes		-83.49	-170.62	-193.95	-171.29	-142.03	**-761.38**	**15,553.22**
Reduction in Unfunded Social Security Liabilities								**21.43**
Reduction in Government Long-Term Obligations								**15,574.65**

Note: * "Present Value" is an accounting term that measures how much money would need to be invested today to finance future obligations. For more information about the economic assumptions and discount rate used, see Appendix A.
The baseline revenue forecast contains CBO's latest estimates for FY1998 and FY1999. For FY1999 through FY2003, the revenue and outlay forecasts include Heritage adjustments. Projections of current CBO, five-year cumulative surplus is $274 billion. The comparable figure from the Office of Management and Budget is $496 billion. Government long-term obligations include all major components of spending.
Source: See Appendix A.

[1] CBO, For Better or For Worse, p. 10.
[2] Ibid., p. 12.

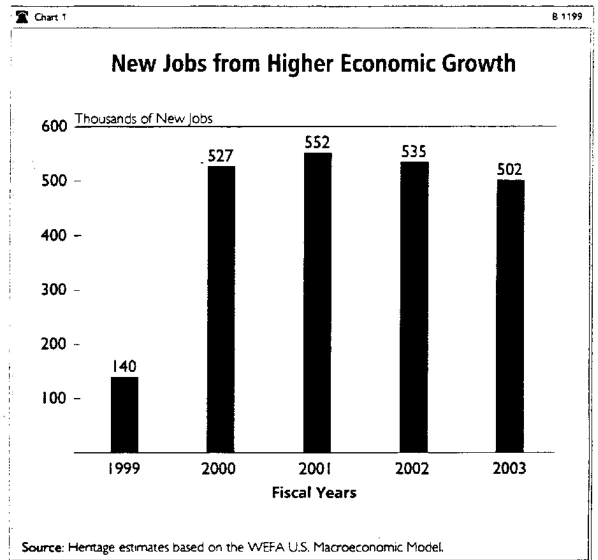


Chart 1
B 1199
New Jobs from Higher Economic Growth
Thousands of New Jobs
600
500
400
300
200
100
140
527
552
535
502
1999
2000
2001
2002
2003
Fiscal Years
Source: Heritage estimates based on the WEFA U.S. Macroeconomic Model.

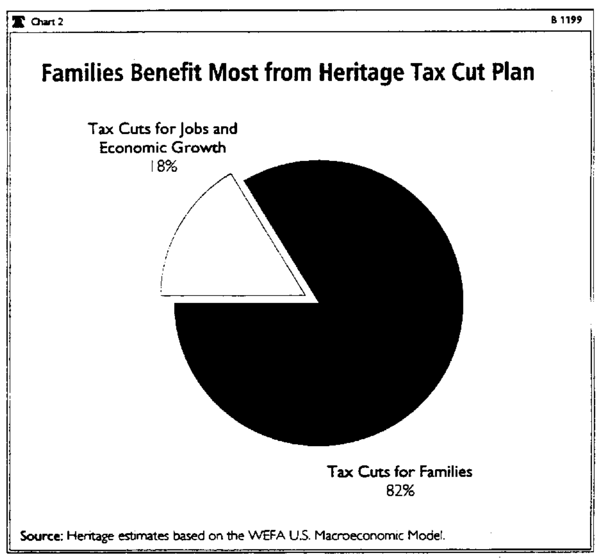
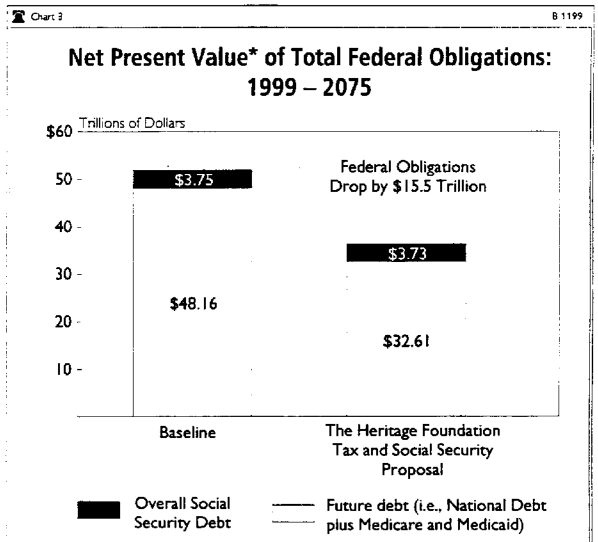
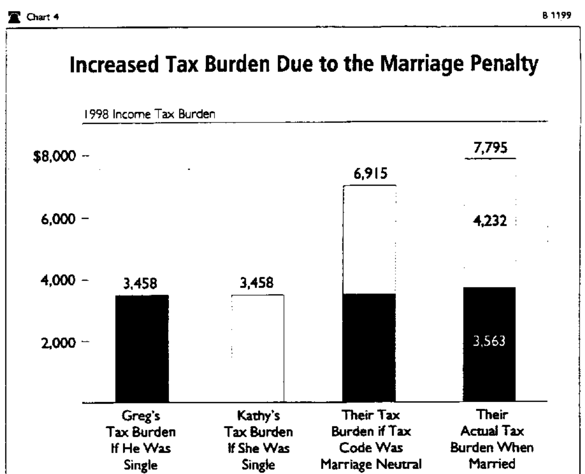


Chart 2
B 1199
Families Benefit Most from Heritage Tax Cut Plan
Tax Cuts for Jobs and Economic Growth
18%
Tax Cuts for Families
82%
Source: Heritage estimates based on the WEFA U.S. Macroeconomic Model.



Note: * "Present Value" is an accounting term that measures how much money would need to be invested today to finance future obligations. Some obligations have been omitted for clarity — however, all major components are taken into account.
Source: See Appendix A.



Note: In this scenario, Greg and Kathy both earn $30,000. They take standard deductions and exemptions. They have no children. As a couple, they filed jointly. Totals may not add up due to rounding.
Source: Heritage calculations, based on IRS Tax Tables.

Table 2 B 1199

Estimated Distribution of Individual Capital Gains Tax Relief

Regular Income Before Claiming Capital Gains	Percent of Filers Who Declare Capital Gains	Cumulative Percentage	Percent of Total Value of Capital Gains	Cumulative Percentage
Under $30,000	41.18%	41.18%	29.83%	29.83%
$30,000 to $39,999	11.12%	52.31%	5.25%	35.08%
$40,000 to $49,999	9.28%	61.59%	4.63%	39.72%
$50,000 to $74,999	17.42%	79.01%	8.77%	48.49%
$75,000 to $99,999	8.67%	87.68%	6.01%	54.50%
Over $100,000	12.32%	100.00%	45.50%	100.00%

Source: Heritage calculations; based on IRS Public Use File for 1993.

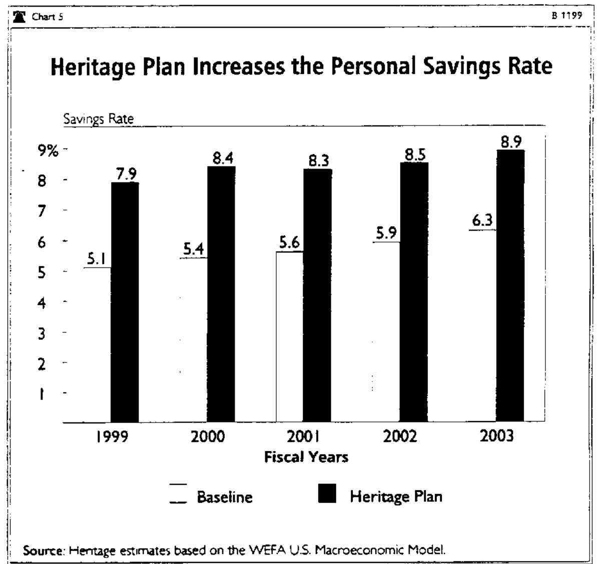


Chart 5
B 1199
Heritage Plan Increases the Personal Savings Rate
Savings Rate
9%
8
7
6
5
4
3
2
1
5.1
7.9
5.4
8.4
5.6
8.3
5.9
8.5
6.3
8.9
1999
2000
2001
2002
2003
Fiscal Years
Baseline
Heritage Plan
Source: Heritage estimates based on the WEFA U.S. Macroeconomic Model.

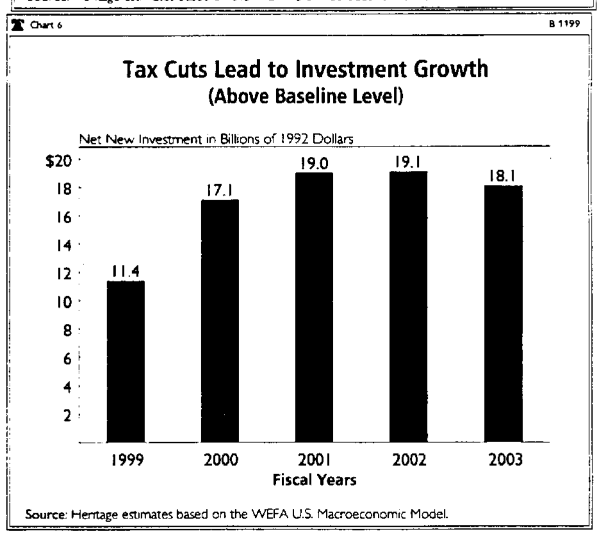


Chart 6
B 1199
Tax Cuts Lead to Investment Growth
(Above Baseline Level)
Net New Investment in Billions of 1992 Dollars
$20
18
16
14
12
10
8
6
4
2
11.4
17.1
19.0
19.1
18.1
1999
2000
2001
2002
2003
Fiscal Years
Source: Heritage estimates based on the WEFA U.S. Macroeconomic Model.

APPENDIX B

How the Heritage Tax Plan Would Affect Selected Economic Indicators

	Fiscal Year 1999	2000	2001	2002	2003	Average FY1999–FY2003
Gross Domestic Product			In Billions of 1992 Dollars			
Heritage Plan	7,576.4	7,741.8	7,902.3	8,068.4	8,250.9	7,908.0
Baseline	7,551.9	7,693.6	7,848.4	8,014.0	8,200.7	7,861.7
Difference	24.5	48.2	53.9	54.4	50.2	46.2
Employment			In Thousands of Jobs			
Heritage Plan	126,867	128,684	130,194	131,655	133,175	130,115
Baseline	126,727	128,157	129,642	131,120	132,673	129,664
Difference	140	527	552	535	502	451
Unemployment Rate			Percent of Civilian Labor Force			
Heritage Plan	5.2	5.2	5.4	5.6	5.7	5.4
Baseline	5.1	5.4	5.6	5.8	5.9	5.6
Difference	0.1	-0.2	-0.2	-0.2	-0.2	-0.1
Disposable Personal Income			In 1992 Dollars			
Heritage Plan	5,806.4	5,976.9	6,112.0	6,253.5	6,408.2	6,111.4
Baseline	5,619.6	5,744.0	5,873.3	6,008.5	6,159.5	5,881.0
Difference	186.8	232.9	238.7	245.0	248.7	230.4
Personal Savings			In 1992 Dollars			
Heritage Plan	536.3	603.9	630.1	675.2	741.1	637.3
Baseline	337.2	378.5	408.5	451.0	511.9	417.4
Difference	199.1	225.4	221.6	224.2	229.2	219.9
Personal Savings Rate			Percent of Disposable Income			
Heritage Plan	7.9	8.4	8.3	8.5	8.9	8.4
Baseline	5.1	5.4	5.6	5.9	6.3	5.7
Difference	2.8	3.0	2.7	2.6	2.6	2.7
Investment			Billions of 1992 Dollars			
Heritage Plan	984.9	1,033.0	1,071.6	1,106.8	1,143.2	1,067.9
Baseline	973.5	1,015.9	1,052.6	1,087.7	1,125.1	1,051.0
Difference	11.4	17.1	19.0	19.1	18.1	16.9
Housing Starts			Millions			
Heritage Plan	1.470	1.506	1.459	1.450	1.434	1.464
Baseline	1.458	1.480	1.434	1.433	1.426	1.446
Difference	0.012	0.026	0.025	0.017	0.008	0.018
Light Vehicle Sales			Millions			
Heritage Plan	14.835	15.630	16.068	16.130	15.992	15.731
Baseline	14.863	15.488	15.931	16.033	15.942	15.651
Difference	-0.028	0.142	0.137	0.097	0.050	0.080

Note: Some totals may not add due to rounding.

How the Heritage Tax Plan Would Affect Selected Economic Indicators

	Fiscal Year 1999	2000	2001	2002	2003	Average FY1999–FY2003
Real Federal Funds Rate	Annualized Percent					
Heritage Plan	5.6	5.1	5.1	5.3	5.4	5.3
Baseline	5.7	5.3	5.2	5.3	5.3	5.4
Difference	-0.1	-0.2	-0.1	0.0	0.1	-0.1
Treasury Bond, 30 Year	Annualized Percent					
Heritage Plan	6.4	6.2	6.2	6.3	6.2	6.3
Baseline	6.4	6.2	6.2	6.2	6.0	6.2
Difference	0.0	0.0	0.0	0.1	0.2	0.1
Consumer Price Index	Annualized Rate of Change					
Heritage Plan	2.3	2.6	2.8	2.9	2.8	2.7
Baseline	2.5	2.7	2.8	2.8	2.8	2.7
Difference	-0.2	-0.1	0.0	0.1	0.0	0.0
User Cost of Capital	Index Value, Annualized Rate					
Heritage Plan	101.2	100.8	100.5	101.8	101.6	101.2
Baseline	106.3	105.8	105.1	106.0	105.3	105.7
Difference	-5.1	-5.0	-4.6	-4.2	-3.7	-4.5
Output Per Hour	Annualized Rate of Change, Non-Farm Businesses					
Heritage Plan	0.5%	0.9%	0.9%	0.7%	1.2%	0.8%
Baseline	0.2%	0.9%	0.8%	0.7%	1.2%	0.8%
Difference	0.3%	0.0%	0.1%	0.0%	0.0%	0.0%

Fiscal Effects
(Excluding Revenue Allocation to Private Savings Accounts)

Change in Federal Tax Revenue	(Billions of Current Dollars)					Total
Static Change in Tax Revenues	-51.5	-61.5	-64.2	-66.5	-70.0	-313.6
Dynamic Change in Tax Revenues	-23.8	-50.0	-52.5	-56.0	-58.4	-240.7
Revenue Feedback	27.7	11.5	11.7	10.5	11.6	73.0
Feedback Percent	53.8%	18.7%	18.2%	15.8%	16.6%	23.3%
Change in Net Federal Deficit	(Billions of Current Dollars)					Total
Baseline Surplus Forecast (WEFA)	-2.0	-3.0	12.0	68.0	52.0	127.0
Static Surplus Forecast	-53.5	-64.5	-52.2	1.5	-18.0	-186.6
Dynamic Surplus Forecast	-25.0	-51.1	-37.3	11.4	-13.2	-115.1
Economic Feedback	28.5	13.4	14.9	9.9	4.8	71.5
Feedback Percent	53.3%	20.8%	28.6%	673.0%	26.8%	38.3%

Note: Some totals may not add due to rounding

Mr. MATSUI. My time has run out. I thank you. My time has run out, but I want to thank all the witnesses for testifying today.

Chairman SHAW. Mr. Levin.

Mr. LEVIN. Let me ask a question that is directly relevant to the caption of the hearing, because we were going to focus on the impact on the minorities and low-income families, and those with disabilities. It's tempting to move beyond it, but before—and I will probably do the same, but let me just ask you, Mr. Beach: You were here for the GAO report, which comes to a different conclusion than you did earlier. I think that is safe to say. Do you accept the GAO analysis?

Mr. BEACH. I have not read it, Congressman. I was sitting in the back of the room in a covey of teenagers and was unable to hear the majority of what was said up here at the panel. Teenagers are noisy—well, they had a number of comments about the panel and the distinguished testimony. [Laughter.]

So I have been privileged to advise GAO on some of their work, and they have come to the Foundation. We have worked with them on understanding data, what the longitudinal data does and what other kinds of data does to rates of return. I am looking forward to their statement, but I would be giving you a speculative response if I said I knew anything about it.

Mr. LEVIN. Well, could you supply this Subcommittee your analysis?

Mr. BEACH. You bet. When it is done, we will be writing a memo and an analysis on it, because we have a very close interest in their work. I will be happy to supply each member with that analysis.

[The following was subsequently received:]

Heritage Foundation Backgrounder No. 1238, December 3, 1998

THE COSTS OF MANAGING INDIVIDUAL SOCIAL SECURITY ACCOUNTS

David C. John and Gareth G. Davis [1]

Administrative costs are an important part of the debate about the future of Social Security. Even though it is widely acknowledged that Americans could have a much more prosperous retirement if their Social Security taxes earned a better rate of return, some critics claim that the allegedly high administrative costs of individually owned and privately managed Social Security accounts would sharply reduce this gain. As this paper will show, such charges are not true.

Creating and administering a retirement program does not require rocket science, and while the task may be difficult, it is not impossible. To keep administrative costs low, a simple retirement program could start with individually owned accounts with limited investment options. Existing private investment plans—ranging from stock index mutual funds to multi-employer defined contribution retirement plans—could be adapted to a system of individual Social Security accounts. In some cases, administrative fees could be as low as 0.20 percent of fund assets; in all cases, they would continue to decline over time. History shows that administrative costs are highest when a system is first implemented and start-up costs must be covered. As a system matures, costs decline sharply. For instance, administrative costs at the federal Thrift Savings Plan (TSP) declined 76 percent over the TSP's first ten years of operation.

Administering a system of more than 140 million individual Social Security accounts involves little more than processing data. Similar financial data systems already exist. The nation's three largest privately owned credit bureaus, for instance, administer databases that average 190 million accounts, most of which are updated monthly. As computer technology increases, the difficulty of administering such immense databases will continue to diminish. Market competition keeps administrative costs low for the millions of Americans who currently own mutual funds and similar investments. There is every reason to believe that market competition would have the same effect on individual Social Security accounts.

In the upcoming debate on Social Security, Congress and the President should work to structure a simple system of individually owned, privately managed Social Security accounts. They should look beyond the pension industry for examples of technology and management techniques that can be adapted to this task. And they should not assume that any aspect of creating or managing these accounts must necessarily be handled by a federal agency.

[1] The authors extend a note of thanks to Mark Wilson, Labor Economist in The Center for Data Analysis, for his contributions to this paper.

INDIVIDUAL SOCIAL SECURITY ACCOUNTS: A MODEL

A retirement program's costs are determined largely by its structure, and seemingly minor structural changes can affect administrative expenses significantly. A host of proposed programs that would establish individual Social Security accounts are likely to follow the pattern of development that 401(k) plans took, beginning as simple programs and adding features over time.

Although administering a retirement program may be complex, private businesses and the government have run such plans for decades. It is not necessary for Washington to invent either the technology or the investment options to give Americans an opportunity to save more money for retirement. Computers today are capable of tracking the investments of almost 190 million people. Risk-reducing investment programs, such as stock index mutual funds, that could be used to increase the retirement benefits available under Social Security also exist.

Of course, every retirement program, whether privately or governmentally managed, incurs administrative costs. These costs cover such items as the collection of money and information from employees or employers, the investment of that money, and the processing of retirement claims and benefits payments. Costs are directly related to the complexity of the plan, the level of service provided, and the number of available investment options (see page 3). It should go without saying that a simple system with very limited service—such as today's Social Security system—will cost much less to administer than one that is more complex and provides more information and services.

To make this study more meaningful, it is necessary to consider what Heritage expects private accounts to look like. The simplest, and most likely, Social Security accounts would be individually owned and privately managed, and have a limited number of investment options. Participants would be allowed to choose among a Standard & Poor's 500 Index mutual fund, a high-grade corporate bond fund, or a super-safe government bond fund that invests in the new Series I Savings Bonds. These bonds are designed specifically for retirement savings and pay an inflation-adjusted rate of return that is guaranteed for the 30-year life of the investment.[2]

Administrative costs can be kept low. The Social Security system already spends $2 billion a year to administer retirement and survivors benefits. For the average household of two 30-year-old workers with children who each earned just under $26,000 in 1996, however, it will provide a return on their taxes of only about 1.23 percent after inflation.[3] If this family had invested the same dollar amount in a portfolio of 50 percent equities and 50 percent government bonds, they could have earned a return of 5 percent or better. Although the administrative costs would be slightly higher in this program than under the current Social Security system, the increase in the couple's return would more than make up for the added administrative expense. In this example, the couple will have an additional return of 3.77 percent on their taxes, and even after paying administrative costs should be able to keep about 90 percent of the increase.

HOW TO ADMINISTER INDIVIDUAL SOCIAL SECURITY ACCOUNTS

A system of individually owned, privately managed Social Security accounts would be far larger and more complex than any existing retirement plan. The task of setting up and managing such a plan should not be underestimated. But it is not technologically impossible, nor would it have to be administered by the federal government.

This is really a question of data management. The Social Security program today administers about 140 million accounts. By contrast, the three largest private credit bureaus currently administer databases of more than 190 million accounts and, on average, update each active account monthly. These existing private systems are almost a third larger than Social Security, yet they post their account changes much faster. This type of data management could be adapted to a system of individual Social Security accounts.

Moreover, setting up a system of individually owned, privately managed Social Security accounts should become easier over time: The computer industry estimates that the capacity of a computer chip doubles roughly every 18 months.[4] And programming ability has kept pace with this rapid growth in hardware capability.

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[2] For more information about Series I bonds, see the U.S. Treasury's Web site at http://www.publicdebt.treas.gov/sav/sbiinvst.htm.

[3] William W. Beach and Gareth G. Davis, "Social Security's Rate of Return," Heritage Foundation Center for Data Analysis Report No. 98–01, January 15, 1998.

[4] "It Seems Like Yesterday," The Wall Street Journal, November 16, 1998, p. R10.

Data processing could be contracted out to a private entity. In the United Kingdom, for example, the administration of the privatized segment of its social security system has been contracted out to the accounting firm of Arthur Andersen. Contracting out could be structured so that the processing contractor uses only the latest computer equipment. This stipulation would afford the manager of the plan the best technology available. The system would not be burdened and slowed by outdated hardware or software owned by the government or a previous contractor.

Transferring money to a funds manager is becoming more efficient and timely in the private sector. Years ago, private financial institutions developed an efficient, low-cost, and fast electronic funds transfer system (EFTS). Today, thousands of companies and financial institutions use EFTS to move billions of dollars daily. This method could be adapted for use with individually owned and privately managed Social Security accounts.

Thus, because of the rapid increases in computer capabilities today, establishing and administering individually owned Social Security accounts will become faster, easier, and less costly in the future.

A PATTERN OF DECLINING COSTS

History shows that administrative costs are highest when a system is first implemented and start-up costs must be covered. As time goes on, administrative costs decline significantly. This is true in the case of 401(k) accounts, the Thrift Savings Plan for federal employees, and even Social Security.

Over the years, for example, the administrative costs of 401(k) plans have decreased despite the growth in investment options and the level of personal service. Although the costs of specific plans vary according to each plan's complexity and size, as well as the type of assets in which the plan is invested, many large companies have been able to keep their annual costs as low as 0.3 percent by offering only a limited number of broad-based funds.[5]

The federal Thrift Savings Plan, which is a privatized retirement plan open only to federal employees, has seen an even more dramatic reduction in administrative costs. Since the system started in 1988, administrative costs have decreased by 76 percent.

Social Security showed similar reductions during its formative years. In 1940, when the system first began to pay benefits, its administrative costs equaled 74 percent of all Old-Age and Survivors' Insurance (OASI) benefits paid. In 1945, this figure had declined to 9.8 percent.[6] Today, administrative costs make up only 0.64 percent of payments from the OASI trust fund. Even though Social Security's structure has changed over the years so that this is not a perfect comparison, it does give analysts an idea of the possible size of the reduction.

THE COSTS OF INDIVIDUALLY OWNED SOCIAL SECURITY ACCOUNTS

Few people dispute that individual Social Security accounts can work in theory. The question concerns how much they will cost to administer in practice. There is powerful evidence from real-world examples that the increased administrative costs of a private system are small in comparison with the increased income generated by the accounts.

The sources for the information on probable administrative costs of a system of worker-controlled accounts include (1) existing private retirement programs, such as employer-provided pension plans and 401(k) plans; (2) management fees on mutual funds and other private investments; and (3) privatized social security systems in other countries.

Private Retirement Plan Costs

Plans offering individually owned and privately managed Social Security accounts would resemble a number of private retirement and investment plans currently available in the United States. Although the actual costs of such accounts would be determined by how a program of individual Social Security accounts was implemented, their administrative costs would approximate those of a fully privatized system.

Defined Contribution Plans. Individual Social Security accounts are likely to be structured like the existing defined contribution retirement plans currently offered

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[5] Testimony of James S. Phalen, Executive Vice President, State Street Bank and Trust Company, before Committee on the Budget, U.S. Senate, 105th Cong., 2nd Sess., July 21, 1998, p. 3.

[6] Social Security Administration, 1998 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, p. 97.

by various U.S. employers. Defined contribution plans allow workers to invest up to a certain level of income (which may be matched, either partially or wholly, by the employer) in a specified range of investments. A 1996 U.S. Department of Labor report suggests that the expenses associated with administering defined contribution plans are very low. In 1992, total annual costs for these plans amounted to $34.99 per participant, or just over 0.17 percent of total assets held.[7]

The expenses associated with a private account can be divided into categories. Investment advisory and management fees generally are set as a fixed percentage of a fund's balance. Other fees, such as record-keeping and legal fees, usually are a fixed amount regardless of the balance in an account. Using these as assumptions and the data from the report, the expenses associated with each employer-provided defined contribution account in 1992 amounted to $24.99 per account, plus an investment fee of 0.05 percent of the account balance. In 1992, this investment fee equaled $10 per account, bringing the total annual cost to the $34.99 cited above.

401(k) Plans. Another fast-growing private component of the U.S. retirement savings system is made up of employer-sponsored 401(k) plans, which range in size and complexity. Initially, most 401(k) plans offered members few investment choices and a low level of service. Over time, however, some added dozens of ways to invest the contributions, and several plans even allow members to rearrange their investments on a daily basis.

Currently, over $1 trillion is invested in 401(k) plans. According to University of Pennsylvania Professor Olivia Mitchell, who recently completed an extensive analysis of the likely costs of a private Social Security system, "On an annual basis, the average per participant cost of administering a 401(k) plan appears to be between $5.00 and $55.00 annually, including non-discrimination testing, quarterly statements, and investor information." [8]

Declining Costs. These private retirement programs cover a variety of products available in the consumer market. A system of private Social Security accounts most likely would be structured so that administrative costs would be even lower than those assessed by private retirement accounts today. This is because a privatized Social Security system operating on a national scale would have many more participants than the private alternatives have. And as the number of accounts increases, the cost-per-participant would tend to fall as "fixed" costs, such as the cost of computer hardware, are spread over a greater number of participants.

Private retirement programs tend to offer a large degree of investment choices, including relatively expensive (and riskier) products such as international equity funds. In a system of individually owned and privately managed Social Security accounts, at least initially, federal prudential regulations likely would confine retirement investments to inexpensive and less risky assets, such as U.S. Treasury bonds and passively managed mutual funds that track broad market indexes like the Standard & Poor's 500 Index.

In this context, perhaps the best indicator of the costs of a system of individual Social Security accounts is the Thrift Savings Plan operated by the federal government for its workers. At the end of 1995, the TSP provided its 2.2 million participants with a comprehensive retirement package that included optional annuities and allowed employees a limited set of investment alternatives. Participants divided their investments among three plans, including a stock index fund, a corporate bond fund, and a government debt fund. In 1995, investment and administrative costs for the TSP totaled 0.09 percent of net assets, or $15.20 for each participant.[9]

Administrative Costs of Mutual Funds and Other Private Investments

Mutual Funds. Mutual funds are an extremely popular way to save for retirement. The Investment Company Institute estimates that about 35.5 percent of all the assets in retirement plans are invested in mutual funds.[10] For individual retirement accounts (IRAs), which in most cases are self-owned and self-directed instead of affiliated with an employer, the figure is higher, with 42 percent of assets invested in mutual funds.[11]

One of the most suitable forms of investment for retirement is an index fund that passively tracks a broad market index such as the S&P 500, the Dow Jones Indus-

[7] Olivia S. Mitchell, "Administrative Costs in Public and Private Retirement Systems," in Martin Feldstein, ed., Privatizing Social Security (Chicago, Ill.: University of Chicago Press, 1998), p. 433.

[8] Ibid., p. 437.

[9] Arthur Andersen, LLP, Report of Independent Public Accountants to the Executive Director of the Federal Employee Thrift Investment Board, 1996.

[10] "Mutual Funds and the Retirement Market," Fundamentals, Investment Company Institute Research in Brief, Vol. 7, No. 2 (July 1998).

[11] Ibid.

trial Average, or the Russell 2000. Mutual funds following this investment strategy usually have very low administrative and investment costs.

According to Lipper Analytical Services, the principal provider of fund fees and expense data to the mutual fund industry, the median administrative cost of funds that follow the S&P 500 was just 0.38 percent.[12] One such fund offered by Vanguard has a cost that is only 0.19 percent of assets.[13] Although the median expense ratio for all mutual funds invested in equities is 1.38 percent, this amount includes a number of funds that would probably be unsuitable for individual Social Security accounts, such as those with extremely risky investment strategies.

U.S. Treasury Bonds. U.S. Treasury bonds constitute an extremely inexpensive and risk-free retirement savings option. According to Lipper Analytical Services, the median mutual fund invested in U.S. Treasury bonds has an expense ratio of 0.83 percent.[14] But it may not even be necessary for an individual to use a mutual fund to hold bonds.

An extremely low-cost retirement investment with no management fees and no risk would be the U.S. Treasury Department's new Series I Savings Bonds. Designed for retirement savings, these bonds pay an inflation-adjusted rate of return that is guaranteed for their 30-year life. They can be purchased for no cost from almost any local bank branch in denominations as low as $50. Savings bonds issued through April 1999 will pay a guaranteed real rate of 3.3 percent for the next 30 years.[15]

The Australian and British Private Social Security Systems

The experience of other countries is also instructive. The closest comparisons to the U.S. system are those of Australia and Britain, two developed nations with sophisticated financial markets that have partially privatized their social security systems.

According to government statistics, annual administrative costs for Australia's system of private accounts totaled 0.85 percent of fund assets in the first quarter of 1998—the equivalent of an annual average cost per participant of $70.20 in Australian dollars (or US $44.71). A number of funds in Australia offer participants total fixed annual costs of $52 (or US $33.12 per year).[16]

Britain's system illustrates the importance of requiring a simple, easy to understand disclosure of fee schedules. Although several major banks advertise that their annual fees will be 1.0 percent of assets, fees for the popular Group Personal Pensions (GPP) tend to be confusing. An October 1998 survey of these plans[17] showed that, in addition to annual management charges, all plans also charged commissions and various annual policy fees. While the total cost may be clear to financial professionals, it can be highly confusing to the average investor. However, GPP plans usually are offered through the employer, which often pays the fees, and appear to be negotiable for larger employers.[18]

THE IMPACT OF ADMINISTRATIVE COSTS ON AVERAGE-INCOME PARTICIPANTS

Although individual Social Security accounts may cost slightly more to administer, the benefits they generate will far outweigh these costs. This is particularly important to remember in light of the low rate of return offered by the current Social Security system. An administratively "cheap" system may offer a lower level of retirement security than a system that offers higher rates of return, but it also costs more to administer. Consider the following example.

A typical young worker makes $25,000 in 1998. This worker chooses to invest 3 percent of that income ($765) in a system of private accounts. Assume that:

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[12] Unpublished data provided by Lipper Analytical Services, October 1998.

[13] Ibid.

[14] Ibid.

[15] U.S. Department of the Treasury, Bureau of the Public Debt, "U.S. Savings Bond Home Page," at www.publicdebt.treas.gov/sav/sav.html.

[16] Australian Government Publishing Service, Insurance and Superannuation Commissions Statistical Bulletin, various issues. U.S. dollar valuations based on exchange rate of 1.57 (quoted on http://www.cnnfn.com on November 25, 1998). See also Daniel J. Mitchell and Robert P. O'Quinn, "Australia's Privatized Retirement System: Lessons for the United States," Heritage Foundation Backgrounder No. 1149, December 8, 1997.

[17] "Take Your Pick," GP Magazine, October 1998, p. 5.

[18] See also Robert E. Moffit and Louis D. Enoff, "Social Security Privatization in Britain: Key Lessons for America's Reformers," Heritage Foundation Backgrounder No. 1133, August 6, 1997.

• The cost of administering this account is $50 (which is the worst-case scenario—an annual fee of $50 lies at the upper range of the data on average costs presented earlier in this paper);

• Costs are allocated on a flat basis per account so that workers with $1 million in their accounts pay the same fixed charge as workers with $50 in their accounts (in practice, costs should vary with the size of the account, so costs of the relatively small account would be much less than $50); and

• The worker allocates 50 percent of the account to U.S. Treasury bonds yielding 2.8 percent per year after inflation, and 50 percent to a broad market equity index fund yielding 7 percent per annum after inflation. Earnings are assumed to grow at one percent after inflation.[19]

Although critics of individual Social Security accounts usually focus on the impact of administrative costs on the first year of earnings, this is a long-term investment, and fees should be considered the same way. In this case, the $50 administrative cost absorbs just over 6.5 percent of the account's balance during its first year. However, administrative costs fall rapidly and amount to less than 1.0 percent of the account balance within six years. Thus, the claim that the higher returns of private accounts would be wiped out by their administrative costs is demonstrably false, especially if one takes the medium-or long-term perspective that is appropriate for retirement planning.

The Social Security Administration's own projections imply that the mixed bond/equity portfolio described above would yield an after-inflation return of 4.9 percent per annum before administrative costs are included.[20] By contrast, according to the Social Security Administration's own calculations, a male child born in 1997 who earns a low income can expect to receive only 1.95 percent from Social Security after inflation.[21]

Chart 1 compares the performance of the high yield/"high" administrative cost private account with the performance of a plan that invests in an asset with the same yield as Social Security. The Social Security Administration has already considered administrative costs in calculating this yield. In the first scenario, the worker saves 3 percent of income in a private account and earns a return of 4.9 percent per annum. In the second scenario, the worker makes a similar investment decision but pays an annual administrative fee of $50. In the third scenario, his money is retained in a Social Security-type investment and yields a post-inflation return of 1.95 percent per annum.[22]

Over the long term, the power of compound interest and the higher return from private investments entirely negates the initial impact of higher administrative costs within six years. At the end of the 40-year period, administrative costs have reduced the difference in returns between the low cost/low return Social Security-type asset and the private account by only 11 percent.

CONCLUSION

Administrative costs are not a barrier to creating a system of individually owned and privately managed Social Security accounts. It is not that difficult to structure the new system to keep accounts simple and costs low. Existing technology allows for the creation of a method to track these investments, and the experience of the United Kingdom shows that the administration of such accounts could be contracted out successfully.

Because administrative costs are determined largely by the structure of the accounts, investment options for these worker-controlled accounts could be limited initially to a stock index mutual fund, a high-grade corporate bond fund, and a government bond fund that invests in the new Series I Savings Bonds. As the system matures and costs drop, additional investment options and consumer features could be added.

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[19] 1998 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, op. cit.

[20] Ibid. and Social Security Administration, Report of the 1994–1996 Advisory Council on Social Security, March 1997.

[21] Average-income workers can expect less. Social Security Administration, Report of the 1994–1996 Advisory Council on Social Security.

[22] A direct comparison with Social Security is not possible, as individual balances do not compound over time within the Social Security system. This example is constructed only for the purpose of illustrating the point that a low-return/low administrative costs is often inferior to an investment that is more expensive to administer but that yields a higher return. However, 1.95 percent is the rate of return the Social Security Administration estimates that a low-income male born in 1997 will receive from Social Security.

All Americans could be earning a higher rate of return on Social Security taxes than is possible today if Washington allowed them to invest in individually owned and privately managed accounts. The low administrative costs of these accounts over time, along with their returns, would provide most Americans with a more secure and prosperous retirement.

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WHAT ARE ADMINISTRATIVE COSTS?

Administrative costs generally include the amount of money that an account owner must pay for maintenance and funds management. In most cases, these costs fall in three general categories: (1) the processing of information related to income and the amount invested; (2) actual funds management; and (3) determining eligibility for benefits and the payment of those benefits. The relative size of each component will vary according to how the plan is structured.

- Information processing is essentially data processing. Salary and contribution information is sent from an employer to a location to be added to the individual's file. Although a database of over 140 million individual Social Security accounts would be far larger than any existing retirement plan, it would still be much smaller than the databases of the three largest existing credit bureaus that maintain an average of 190 million individual accounts.
- Funds management includes the actual selection, purchase, and sale of assets and the cost of research to select investments. Costs vary widely depending on how complex the investment strategy is. The lowest cost would be associated with a stock index fund, in which equal amounts of every stock on the selected index are purchased by computer. These costs could be as low as 0.20 percent of assets. Strategies which try to outdo the market by short-term trades in selected stock or other financial instruments are both expensive and relatively risky. In most cases, funds using this strategy do not realize long-run returns that even equal the market return. For this reason, Heritage would limit these accounts to investing in index funds.
- Benefits determination is a mixture of data processing and human judgment. It involves determining whether individuals meet the criteria for retirement and their appropriate benefits level, and then arranging payment. Once benefits are determined, computers could disperse the monthly payments.

In most cases, administrative costs are measured as a percentage of assets under management. If a fund manages $100 million in assets and its annual expenses come to $500,000, its annual expense ratio would be about 0.50 percent. Percentage of assets is considered the best measure of administrative costs, since it reflects the way that investment management fees are usually assessed and spreads the costs over the entire investment. The one exception is a pay-as-you-go system such as today's Social Security, in which each year's benefits payments are funded by that year's taxes and only the surplus goes into the trust fund. The trust fund is merely a measure of excess taxes collected over time, and not a pool of investments upon which future benefits would be based. Benefits that will be paid to both present and future retirees are determined by a formula that is independent of any measure of the trust fund.

It is also possible to express administrative costs as a percentage of annual contributions to the plan, as a percentage of benefits paid, or as a dollar cost per participant. Comparing one cost measure from one plan against a different cost measure from another is likely to be meaningless. For instance, comparing Social Security's administrative cost of 0.64 percent of benefits paid in fiscal year 1997 with a Standard & Poor's stock index mutual fund's administrative cost of 0.38 percent of assets means as little as comparing the cost of a dozen apples to the cost of a pound of oranges. The comparison is useful only when the same standard of measurement is used.

Administrative costs usually do not include costs that the employer and/or employee incur in sending money or information to the manager of the retirement plan. For both the current Social Security system and private pensions, these costs must be measured separately.

TODAY'S SOCIAL SECURITY IS NOT FREE

Americans pay a high price for their Social Security retirement benefits, especially when Social Security's rate of return is compared with that of private retirement plans. For example, consider the experience of an average household of two 30-year-old workers with children who earned just under $26,000 each in 1996 and who invest in a retirement plan of 50 percent equities and 50 percent government bonds. After inflation, their savings would earn them a return of at least 5 percent annually. Yet under Social Security, they will see a return of only 1.23 percent on their tax dollars.[1]

During fiscal year (FY) 1997, the Social Security Administration spent almost $2 billion to administer its Old-Age and Survivors Insurance (OASI) trust fund,[2] which covers only the cost of the retirement and survivors programs. Other benefit plans such as Disability Insurance (DI) are administered by separate trust funds. The billions of dollars Social Security spent on administrative costs in 1997 represented 0.52 percent of the trust fund's income, or 0.64 percent of the benefits paid during FY 1997. But, because Social Security is an unfunded pay-as-you-go program, measuring these costs as a percentage of assets, from an accounting point of view, is meaningless.

As with any retirement program, Social Security's administrative costs measured in this way declined over time. In 1940, when the system first began to pay benefits, its administrative costs equaled 74 percent of all OASI benefits paid. In 1945, this figure had declined to 9.8 percent.[3] Today, administrative costs make up only 0.64 percent of payments from the OASI trust fund in FY 1997.[4] Social Security's cost structure reflects the nature of the program. On average, the determination of benefit eligibility and payment of monthly benefits account for 93 percent of administrative costs.[5] About 7 percent is spent to collect Social Security taxes and only about 0.01 percent on funds management. Unfortunately, these priorities have resulted in extremely uneven service performance. Furthermore, the current system gives individuals no ability to structure their retirement program to meet their own circumstances. Each retiree simply takes whatever the Social Security program chooses to give.

Social Security takes an average of 17 days to begin benefits payments after receiving an application, yet it regularly takes between 7 and 22 months to post earnings information to an individual's account.[6] Furthermore, the U.S. General Accounting Office (GAO) has criticized Social Security for issuing Personal Earnings Benefits Estimate Statements (PEBES) that are confusing and contain inaccurate information.[7]

ARE SMALL ACCOUNTS A BIG PROBLEM?

Critics of individually owned accounts often point to an apparently large number of low-wage workers. Particular attention has been given to the claim that in 1998, 30 percent of all wage and salary earners earned $10,000 or less. It has been argued that the small amounts of money flowing into the private accounts of these earners are likely to be taken entirely to pay the accounts' higher administrative costs. However, a closer look at the evidence suggests that the problems implied by small accounts may not be as large or intractable as defenders of the status quo claim.

[1] William W. Beach and Gareth G. Davis, "Social Security's Rate of Return," Heritage Foundation Center for Data Analysis Report No. 98–01, January 15, 1998.

[2] $1,998,406,000. See Social Security Administration, 1998 Report of the Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, p. 38.

[3] Ibid.

[4] Ibid.

[5] Olivia S. Mitchell and Annika Sunden, An Examination of Social Security Administration Costs in the United States, Report to the Public Sector Management Division, Latin America and Caribbean Region Technical Department, World Bank, 1993; as cited in Olivia S. Mitchell, "Administrative Costs in Public and Private Retirement Systems," in Martin Feldstein, ed., Privatizing Social Security (Chicago, Ill.: University of Chicago Press, 1998), p. 415.

[6] Kelly Olsen and Dallas Salisbury, "Individual Social Security Accounts: Issues in Assessing Administrative Feasibility and Costs," EBRI Issue Brief, November 1998, p. 13.

[7] U.S. General Accounting Office, "SSA Benefit Statement Well Received by Public, But Difficult to Comprehend," GAO/ HEHS–97–19, December 5, 1996.

According to U.S. Census Bureau data cited by the Employee Benefit Research Institute (EBRI), 53 percent of these low earners consist of workers either at the very end of their careers (older than age 60) or at the very beginning (aged 25 and under).[1] A system of private accounts could be structured to avoid the compulsory inclusion of those over mandatory retirement age or of very young workers who are in the educational system and work only on a part-time basis.

The overemphasis on small accounts is the result of the failure to consider income mobility. Many workers' incomes fluctuate widely from year to year. This fluctuation will not be captured in the annual data. Indeed, there is strong evidence that a large proportion of "low-income" workers in any year are experiencing atypical years, and their earnings in that year do not reflect their long-term income.

A 1996 Syracuse University study examined the income mobility experience during the 1980s of workers aged 25 to 55 (this group excludes most college students whose incomes rise upon graduation and older workers who are nearing retirement).[2] Within one year, 19 percent of all workers in the bottom 20 percent of the population had moved to a higher level. Within five years, 36 percent of workers in the poorest 20 percent of the population moved into the upper 80 percent. These data show that better than one-third of those who, in their prime working ages, are recorded as earning $10,000 or less are experiencing an atypical and temporary downward fluctuation in earnings.

Not only is the scale of the problem of small private accounts overstated, but the solution to this problem could be generated by sound policy decisions. Pricing could be designed so that fund managers are required to charge expenses on the basis of a proportion of fund balances, rather than as flat fees that are proportionately more burdensome on small accounts.

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[1] Kelly Olsen and Dallas Salisbury, "Individual Social Security Accounts: Issues in Assessing Administrative Feasibility and Costs," EBRI Issue Brief, November 1998.

[2] Richard V. Burkhauser, Douglas Holtz-Eakin, and Stephen E. Rhody, Labor Earnings Mobility in the United States: 1970s Versus 1980s, Maxwell School Center for Policy Research, Syracuse University, 1996.

Table 1 B 1238

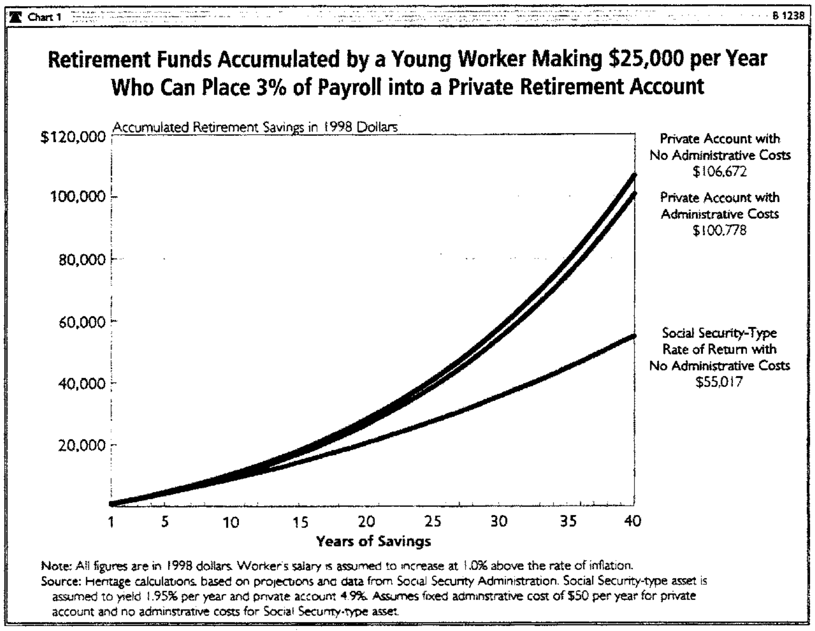
Range of Administrative Costs of Private Retirement Investments

No-Load S&P 500 Mutual Funds*
0.38% of assets
(median of sampled funds)

Defined Contributions Plans**
0.17% of total assets

U.S. Treasury Series I Bonds***
0%

Sources: * Lipper Analytical Services, October 1998; ** Olivia Mitchell, "Administrative Costs in Public and Private Retirement Systems," in Martin Feldstein, ed., *Privatizing Social Security*, 1998; *** U.S. Department of the Treasury, Bureau of the Public Debt, at *http://www.publicdebt.treas.gov/sav/sav.htm*.



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Mr. LEVIN. Have you read Mr. Meyers' critique of your analysis?

Mr. BEACH. Oh, yes, we have read it very closely, and we have responded in two different venues.

Mr. LEVIN. And you don't agree with his criticism?

Mr. BEACH. Well, I am not disagreeing with his representation of the various methods that you use to do these kinds of things, but I think we have, in Mr. Meyers and some other critics who are well-meaning, misunderstanding of what we really are attempting to do in our papers, which began in January and the methods that we have used.

As I pointed out in a letter that I wrote back to a publication called, "The Actuary," and that I have since published in a paper, I would be happy to supply your staff, called, "Social Security's Rate of Return: A Reply to Our Critics," there are a number of common points between us and what Mr. Meyers and Steve Goss does, and there are differences, methodological differences.

We recalculated some of our rates of return using the method proposed by Mr. Meyers and Mr. Goss at the Office of Chief Actuary and came up with some numbers which are somewhat similar to ours. They are a little higher rates of return. We are still waiting for them to do their rates of return and publish those on African-Americans and others.

I would be happy to answer specific questions, but let me just say that the information currently available——

Mr. LEVIN. Why don't you supply it, because I think one of the dangers here for everybody is that they have a conclusion. It is no secret what your conclusion is in terms of where Social Security should go. I mean, that is very clear.

Mr. BEACH. It has been for 20 years.

Mr. LEVIN. I think the danger is that—it is true for everybody—that we are going to kind of look at the facts through the scope of our conclusions. The GAO study is a pretty definite—I won't say, "definitive"—critique of the impact on minorities or critique of your criticism.

So I will await your response to the GAO.

[The following was subsequently received:]

Heritage Foundation Center for Data Analysis Report No. 98–08, December 14, 1998

Social Security's Rate of Return: A Reply to Our Critics

William W. Beach and Gareth G. Davis

In January 1998, The Heritage Foundation published the first paper in a series analyzing Social Security's rate of return.[1] We presented our findings from a detailed study of the retirement income that typical groups of Americans could expect from the retirement portion of their payroll taxes, and we compared this income with the likely return that could be generated by investing those taxes instead in a conservative portfolio of stocks or bonds.

Experts across a wide spectrum of political opinion now concede that Social Security's retirement program provides a poor return for a lifetime of tax payments—the conclusion of the Heritage study as well. Indeed, President Bill Clinton has argued that Social Security's rate of return needs to be higher.[2] Much of the current debate discussing Social Security reform focuses on ways to improve its retirement rate of return—an objective rarely heard just a few years ago.

This new emphasis on Social Security's rate of return has reshaped the Social Security reform debate by connecting the interests of taxpaying workers to such arcane but important concepts as "trust fund balances," "dependency ratios," and other elements of a technical analysis of Social Security's long-term problems. But it also triggered criticisms of Heritage's rate of return analysis. By the time the second Heritage report appeared,[3] for instance, the Commissioner of the Social Security Administration, Kenneth Apfel, had given congressional testimony on its alleged methodological shortcomings, and left-leaning think tanks had begun issuing studies criticizing our work.

As the authors of the Heritage study, we responded promptly to several of these criticisms. Meanwhile, Heritage's Center for Data Analysis continued to offer workers in various age, income, and ethnic groupings information about their publicly funded retirement program—information that the Social Security Administration (SSA) often refuses to produce, even when asked by the presidentially appointed Social Security Advisory Council.[4] Given the current emphasis on Social Security reform, it is both timely and useful to address specific criticisms of our study and offer a more detailed response.

CRITICISMS AND RESPONSES

The following criticisms either paraphrase or, where appropriate, quote from specific objections to our published rate of return studies.[5]

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[1] William W. Beach and Gareth G. Davis, "Social Security's Rate of Return," Heritage Foundation Center for Data Analysis Report No. CDA98–01, January 15, 1998.

[2] Remarks by President Bill Clinton before the National Forum on Social Security, Kansas City, April 7, 1998.

[3] William W. Beach and Gareth G. Davis, "Social Security's Rate of Return for Hispanic Americans," Heritage Foundation Center for Data Analysis Report No. CDA98–02, March 27, 1998.

[4] Members of the 1996 Social Security Advisory Council asked the Office of the Chief Actuary to calculate several rates of return based on several factors, including life expectancy, adjusted for income. The Social Security Administration refused their request. See Sylvester Schieber, Rates of Return on Social Security Contributions: Good Deal, Bad Deal, or Do We Even Care? testimony before the Committee on the Budget, U.S. Senate, January 21, 1998.

[5] William W. Beach and Gareth G. Davis, "Social Security's Rate of Return," Heritage Foundation Center for Data Analysis Report No. CDA98–01, January 15, 1998; "Social Security's Rate of Return for Hispanic Americans," Center for Data Analysis Report No. 98–02, March 27, 1998;

Continued

On Transition Costs

Criticism: The Heritage analysis does not take into account the cost of the transition to a system of private Social Security accounts. The rates of return cited fail to acknowledge that workers entering a private system would have to pay for their own retirement as well as support the benefits paid to those who are currently retired and close to retirement.

Response: The purpose of Heritage's rate of return analysis is to apply a yardstick to measure the performance of the current Social Security system, not to propose or cost out an alternative plan. To that end, the comparison of outcomes under Social Security today with outcomes under a hypothetical private system illustrates the opportunity costs of the current program instead of setting out a specific blueprint for reform. In other words, the Heritage analysis provides a benchmark for comparing alternative reforms.

Rate of return outcomes vary enormously, of course, depending on the transition rules that are adopted. Interim financing could be raised through tax increases, benefit cuts, and the issuance of debt—which pose widely different implications for the rates of return of different groups. To impose an arbitrary transition rule on the model would serve to undermine the validity of the analysis as an examination of the "pure" opportunity cost of the current system.

Moreover, it is far from certain that including transition costs would significantly alter the differences in rates of return between the current system and a private system, since maintaining the current system as a viable long-term program also involves large costs. Nevertheless, Mark Weisbrot of the Institute for America's Future has claimed that "as soon as we take into account the real world costs of moving from Social Security to a system of private accounts, the superior return that the [Heritage] authors calculate for private savings vanishes, and in fact becomes negative."[6] In support of his criticism, he cites the increased taxes contained in the 1994–1996 Social Security Advisory Council's Personal Security Account (PSA) proposal to fund the transition to a partially privatized Social Security system.

However, Weisbrot fails to note that the SSA's Office of the Chief Actuary analyzed this PSA proposal and found that, even when transition costs are included, it actually offers a higher rate of return to virtually all participants than the current Social Security system does.[7]

Table 1 shows the returns calculated by the SSA for a low-income single male worker who made $11,000 in 1995, under both the current system (fully funded, using the SSA's own assumptions) and the Personal Security Account proposal of Carolyn L. Weaver, Sylvester J. Schieber, and several other members of the Social Security Advisory Council.

On Rate of Return Methods of Calculation

Criticism: Steve Goss, Deputy Chief Actuary of the Social Security Administration's Office of the Chief Actuary, has charged that

[T]he Heritage study erroneously analyzes a single outcome where an individual is assumed to know how long he or she will live . . . This approach consistently overestimates the expected number of years of work and consistently underestimates the expected number of years after reaching retirement age. As a result, it grossly underestimates the expected rates of return from Social Security retirement benefits . . . Clearly, computed rates of return for all men will be much higher for all men [sic], and, moreover the difference between rates of return for black and white men will be dramatically smaller than if the erroneous Heritage method is used.[8]

Response: This criticism will be addressed directly later in this section, but it is worth noting here that rates of return for 20-year-old white and black male workers—based on Goss's own data and calculating method—are 0.59 percent and −0.15 percent, respectively. When Goss calculates rates of return for whites and blacks in

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and "Social Security's Rate of Return for Union Households," Center for Data Analysis Report No. 98–06, September 7 1998. See also William W. Beach, Gareth G. Davis, and Sarah E. Youssef, "A State-by-State Analysis of the Returns from Social Security," Center for Data Analysis Report No. 98–05, July 30, 1998.

[6] Mark Weisbrot, Flawed Assumptions, Fatal Errors: An Analysis of the Recent Heritage Foundation Report on Social Security's Rate of Return (Washington, D.C.: Institute for America's Future, undated), p. 2.

[7] Social Security Advisory Council, "Findings and Recommendations," Report of the 1994–1996 Advisory Council on Social Security, Vol. I, January 1997, Washington, D.C., p. 51.

[8] Steve Goss, Deputy Chief Actuary, Social Security Administration, memorandum, "Problems with 'Social Security's Rate of Return: A Report of the Heritage Center for Data Analysis,'" February 4, 1998.

this same age group, he will find that the return for blacks is below that for whites and is negative.

We chose our method for calculating Social Security's rate of return after careful consideration of the advantages and disadvantages of three alternatives:

• The "expected value" method involves summing the expected (or "probability adjusted") value of benefits and taxes on a year-by-year basis.

• The "median value" return method calculates the return to the 50th percentile in a population's mortality distribution, and essentially yields the return below which half of a population would receive less.

• The "average life expectancy" method involves first calculating a group's life expectancy and then calculating the return from Social Security for a worker who lives to that life expectancy. This method, which we selected, usually yields results that lie between the "expected" return and the "median" return.

Each of these methods has strengths and weaknesses. Goss favors the expected value method. In his discussion of the Heritage analysis, Goss chose to characterize the method we selected as "erroneous" while failing to note some of the disadvantages of the expected value method as a measure of the typical return for members of a demographic group. The expected value method in particular is susceptible to distortion by skewed data. This can make it an unsuitable estimator of the likely return from Social Security for a typical member of a population.

A simple analysis of an imaginary lottery will illustrate this point. Consider a lottery with a single prize of $1,000,000. There are 1,000 contestants, each of whom pays a stake of $900. According to the method suggested by Goss, the expected price for each individual from this lottery would be $1,000, implying an overall positive (net) return of $100. Yet 99.9 percent of the entrants would actually lose $900. It would be misleading to suggest to potential buyers of these lottery tickets that they will receive $100—based on the expected return method.

Although this is an extreme example, there is evidence that the returns from the current Social Security system, and those for African-Americans in particular, are highly skewed in a similar fashion. Preliminary calculations made by Heritage (which will be the subject of a future publication) suggest that, while the calculated expected return for a group of recipients may be positive, a large majority of the members of this group (up to 70 percent in the case of African-Americans) may in fact receive negative returns from the Social Security program.

Thus, while the expected rate of return may be useful to the actuary who is responsible for administering an entire program (such as the administrator of the lottery mentioned above) and must account for all participants (including exceptional cases like the single winner above), it often is a less useful tool for those charged with advising individual participants on how they likely will fare in the program. This is why many actuaries, especially in the private sector, have long recognized the weaknesses associated with the expected value method. In offering investment advice to their clients, actuaries routinely use the average life expectancy method that we employed in our study. Since our objective was to enable ordinary Americans to compare the likely consequences of remaining within today's Social Security program with their likely returns realized from a reform that incorporates some private investments, it was also logical to adopt the average life expectancy method.

Critics not only characterize the nature of Heritage's methodology, but in some cases mischaracterize or misunderstand the data we used. One such critic, former Chief Actuary of the Social Security Administration Robert Myers, mistakenly claimed that Heritage used a life expectancy of exactly 69 years for a 21-year-old African-American male. In fact, we used a life expectancy of 73.81 years, which was based on projections made by the U.S. Census Bureau and the Social Security Administration and takes into account future improvements in longevity.

Perhaps the most flagrant example of mischaracterization of the Heritage approach was the use by the Center on Budget and Policy Priorities (CBPP)[9] of a table created by Steve Goss of life expectancies for 20-year-old white and black males in 1997. This table featured prominently in a paper attacking the Heritage rate of return studies. The use of this table was misleading on a number of levels. Among them:

• The table referred to examples that were not even computed in our study. For example, we did not calculate the rates of return for any white males at all, or for any African-American males born after 1975.

[9] Kilolo Kijakazi, African Americans, Hispanic Americans and Social Security: The Shortcomings of the Heritage Report (Washington, D.C.: Center on Budget and Policy Priorities, October 5, 1998).

• The data presented in the Goss table were drawn from a different source (the 1992 Life Tables of the United States [10]) than the one we used and were inappropriate for calculating rates of return from Social Security. In particular, the Life Tables figures are based solely on demographic conditions prevailing in 1992 and, unlike the data used by Heritage, do not take into account likely improvements in life expectancy in the future.

Ironically, despite these shortcomings, the data presented by Goss in this table and prominently featured in the CBPP study can be used to illustrate both the shortcomings of the expected value method favored by Goss and the robustness of the general results calculated in the Heritage study.

According to the data in the 1992 Life Tables, half of all 20-year-old black males who enter the labor force will die before they reach the age of 69.7. Half of all white 20-year-old males will die by age 77. If the retirement age is 65, this means that half of all black male workers will die before receiving Old-Age and Survivors Insurance (OASI) benefits for 4.7 years, and half of all white male workers will die before receiving OASI benefits for 12 years. According to Goss's expected value method, however, "typical" black and white males would receive, respectively, 8.1 years and 12.1 years of benefits. In reality, over 60 percent of black males and 50 percent of white males will die before collecting benefits for this length of time.

The expected value method produces results that do not represent the experiences of African-American males. As Table 2 shows, the Goss method suggests that an "average" black male worker fares much better from Social Security (paying taxes for only 4.8 years for each year of benefits) than the median black worker (paying taxes for 9.6 years for each year of benefits). In statistical terms, this difference is due to the concentration of very high rates of return among a very few individuals. But, as noted above, far fewer than half of all black males will receive a rate of return as favorable as the average rate of return estimated by Goss's method. The racial disparity between the return received by the 50th white worker and the return received by the 50th black worker is also much greater than the disparity revealed in Goss's "expected value" method.

Even if the expected value methodology and data cited by Goss are used to evaluate the rate of return from Social Security, the major conclusions of the Heritage study remain unrefuted. To show this, we calculated the expected rate of return from Social Security for the two men described in the Goss memorandum using his "expected value" method. In line with U.S. Department of Labor data, we assumed that the white worker would earn 118 percent of the national average wage and the black earner would earn 89 percent of the average wage.[11] The results are shown in Chart 1.[12] Chart 1 shows that a black 20-year-old worker in 1998 can look forward to an inflation-adjusted rate of return of −0.15 percent. His white counterpart, however, will "enjoy" a return of 0.59 percent—better, but nothing that should make him too excited. These calculations show that the real rate of return from Social Security remains well below the measures of the opportunity rate of return, even when the expected value method is used (this is the case whether one uses the 2 percent discount rate used by SSA analysts, the 2.5 to 3 percent available from long-term government securities, or the 7 percent real rate of return that the Social Security Advisory Council estimates to be available from equities). In short,

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[10] National Center for Health Statistics, Vital Statistics of the United States, 1992 Life Tables, Vol. II, Section 6, April 1998. It should be noted that this life table is based only on conditions prevailing in 1992. It does not reflect changes in life expectancy that may occur in subsequent years. The original Heritage analysis uses a life table that was adjusted to take into account changes in longevity. The 1992 Life Table cited here is also the one quoted by Steve Goss in his "Problems" memorandum and is used for the purposes of allowing direct comparison with his examples.

[11] These are the ratios of median-wage, full-time-employed white males and black male workers in the final quarter of 1997. See U.S. Department of Labor, Bureau of Labor Statistics Release, "Usual Weekly Earnings of Wage and Salary Workers, Fourth Quarter, 1997," January 22, 1998.

[12] In calculating this rate of return, Heritage analysts made a number of assumptions in order to keep the calculation as close as possible to the example contained in the Goss memorandum. It is assumed that current law taxes and benefits continue in effect, even though the Social Security Trustees project that Trust Fund outgo will exceed income from 2013 onwards. The calculations were based entirely on the mortality conditions contained in the National Center for Health Statistics' 1992 Life Tables of the United States, the source used by Steve Goss in his analysis of the life expectancies of the two workers contained in his memorandum. Because mortality rates for 1992 are available only up to age 85, post-age 85 mortality rates in 1992 are assumed to be the same ratio of the death rate at age 85 as they were reported to be in the National Center for Health Statistics' 1989–91 Life Tables of the United States. Only Old-Age and Survivors Insurance and tax benefits are contained in these calculations.

regardless of the method used to measure its return, Social Security remains a poor retirement investment for either minority or non-minority Americans.

Treasury Department Findings. A number of critics have referred to a series of studies carried out by U.S. Treasury Department researchers James Duggan, Robert Gillingham, and John Greenlees.[13] For example, Steve Goss claimed that

[I]n fact more careful research reflecting actual work histories for workers by race indicates that the non-white population actually enjoys the same or better expected rates of return from Social Security than for the white population. (See Duggan et al., "The Returns Paid to Early Social Security Cohorts," Contemporary Policy Issues (October, pp. 1–13).[14]

The evidence from this valuable study, however, has been misused and distorted. For one thing, the studies carried out by Duggan, Gillingham, and Greenlees refer only to workers born in the period before the one covered in our Heritage study. In particular, the report cited by Goss is based on workers who were born between 1895 and 1922 and who retired between the early 1950s and the mid–1980s. By contrast, the Heritage study calculates returns for workers born after 1932 and retiring from 1997 until 2042. These two periods have seen extensive changes, both in the structure of Social Security taxes and benefits and in socioeconomic differentials in life expectancy. For example, recent trends and projections suggest that the longevity gap between African-Americans and whites, and between rich and poor, is growing.[15]

The other mistake in the use of the Duggan et al. study is that Goss implies we calculated a general weighted average rate of return for all African-Americans and all whites. This is not the case. Such an average is almost impossible to calculate and in practice is meaningless, requiring as it does an amalgamation of workers of all income levels, marital status, ages, etc. Rather, the aim of our analysis was to compare workers of similar age, income level, and family structure.[16] In this respect, the result of the U.S. Treasury Department studies is unequivocal: For the African-American worker, Social Security offers a worse deal than it does for a white worker with an identical income and family structure.

Chart 2, which is based on data from the most recent study by Duggan, Gillingham, and Greenlees, shows that black workers born in 1918 can expect a real rate of return from Social Security that is 0.75 percent below that which a white worker with an identical income will receive.[17]

On the Exclusion of Disability Insurance

Criticism: The Heritage study ignores Disability Insurance (DI). Disability Insurance taxes are included, but not disability benefits. When this is corrected, many of the findings are reversed. This is especially true regarding the result that African-Americans have particularly low rates of return from Social Security.

Response: This common objection is simply wrong and is based on a failure to read our study carefully. DI is a separate program within the Social Security system that has its own tax rate and trust fund. Heritage's study explicitly examined only the Old-Age and Survivors Insurance program within Social Security, ignoring DI taxes as well as benefits.

It is possible to reform the OASI program and leave the Disability Insurance program untouched. With this in mind, both DI taxes and benefits were excluded from the analysis. We carefully accounted for pre-retirement Survivors Insurance by excluding the taxes necessary to purchase this insurance.

The Heritage study thus constitutes a complete and consistent analysis of the retirement portion of Social Security—and only this portion of Social Security. In effect, it assumes that, in the hypothetical partly private system, Disability Insurance

[13] See James Duggan, Robert Gillingham, and John S. Greenlees, "Returns Paid to Early Social Security Cohorts," Contemporary Policy Issues, Vol. 11, No. 4 (October, 1993), pp. 1–13.

[14] Goss, "Problems with 'Social Security's Rate of Return.'" The authors are puzzled by Goss's criticism that they did not use these data in their rate of return studies, because the Duggan et al. study is based on data that are not available to non-federal researchers.

[15] For information on the widening socioeconomic differentials in mortality, see G. S. Popper, W. Hadden, and G. Fisher, "Increasing Disparity in Mortality Between Socioeconomic Groups in the U.S.," New England Journal of Medicine, July 8, 1998.

[16] Duggan et al. did estimate an average for all of the observations in their data. However, because of the lack of data on spouses and family members, these calculations cannot be viewed as unbiased estimates of returns received by the entire white and black populations. For a more extensive discussion, see Daniel Garrett, "The Effects of Differential Mortality Rates on the Progressivity of Social Security," Economic Inquiry, July 1995.

[17] See Schieber, Rates of Return on Social Security Contributions: Good Deal, Bad Deal, or Do We Even Care?

and pre-retirement Survivors Insurance are retained exactly as they exist under current law.

Moreover, no empirical study exists to support the claim of Social Security's defenders that including the DI program in rate of return calculations will offset the racial differentials embedded within the OASI program.[18] Many advocates of the current Social Security system cite higher than average DI payments to black workers as a defense against the criticism that Social Security yields a lower than average retirement rate of return for blacks. Besides the fact that DI payments are made to workers and not retirees,[19] the argument that Disability Insurance is the principal means by which Social Security makes up for poor retirement rates of return is a particularly tortured defense of the current system. It is like telling people whose bank gives a poor return on their savings accounts that they should not worry because their homes are insured.

Even if a study of the combined OASDI program as a whole were conducted and led to a narrowing of racial differentials in rates of return, such a study would itself be vulnerable to the criticism that it failed to include the effects of Hospital Insurance (HI)—more commonly known as the Medicare program. Chart 3 shows that medical expenditures are highly concentrated among the very old.

The inclusion of HI is likely to increase racial differentials in Social Security's rates of return. Compared with the general population, African-Americans have a much lower probability of reaching the very old ages at which medical costs tend to escalate. For example, according to the 1992 Life Tables cited by Goss, a white male has a 40.1 percent chance of living to the age of 80, while a black male has only a 24.3 percent chance.[20]

On the Risk of Private Rates of Return

Criticism: Private investments, unlike Social Security, are highly risky. Given that most people are risk-averse, if the returns from a private system are adjusted for uncertainty, they will compare much less favorably with those from Social Security.

Response: Before addressing the risk associated with private investments, it is important to recognize that Social Security is not inherently less risky than private investments. There are at least two major risks associated with Social Security: a demographic risk and a political risk.

- Social Security's Demographic Risk. Every participant in the Social Security retirement program faces the risk of dying before reaching retirement age. In the event of death, Social Security pays a monthly benefit to a worker's children who are under the age of 18 and to the spouse who cares for these children. However, if a worker is childless or has adult children, the family receives no such pre-retirement Survivors Insurance benefits, other than a one-time-only death benefit of $255.

Widowed retired spouses sometimes collect Old-Age benefits based on the taxes paid by their husband or wife. If they do so, they receive nothing in return for the taxes they themselves have paid. Thus, when one partner of a married couple dies without leaving children under the age of 18, at least one spouse ultimately loses all of the taxes he or she has paid into the system.

Most workers who die between ages 50 and 70 face a high risk of receiving little or nothing in return for a lifetime of paying Social Security taxes. In most cases, their children, if any, are older than age 18 when they die and are ineligible for pre-retirement Survivors benefits. Those who die in a slightly narrower age band (ages 50 to 65) are not eligible to collect full Social Security retirement benefits. Those dying at age 70 are eligible to collect less than five years' worth of full Old-Age benefits.

Chart 4, using the National Center for Health Statistics data cited by Goss,[21] shows that 13 percent of white males and 22 percent of African-American males will die between the ages of 50 and 65. Another 8 percent of all white males and 11 percent of all African-American males will die between the ages of 65 and 70. Thus, one in three African-American males and one in five white males will die between ages 50 and 70.

Stanford University economist Daniel Garrett drew on such data and calculated the variation in returns from Social Security for a single cohort of individuals with the same average life expectancy and income. These variations are shown in Chart 5. For this set of workers, the lifetime net present value of participation in Social

[18] Ibid., p. 30.
[19] Disabled retirees may receive an Old-Age benefit that equals their previous DI payment.
[20] National Center for Health Statistics, 1992 Life Tables of the United States.
[21] Goss, "Problems with 'Social Security's Rate of Return.'"

Security ranges from −$92,259 for the worst-performing percentile to $85,993 for the best-performing percentile, in terms of 1988 dollars in 1990 present values.[22]

• Social Security's Political Risk. The political risk in Social Security arises because workers and families do not enjoy secure property rights, which are enforceable in court, over their future Social Security benefits. The U.S. Supreme Court has ruled in Fleming v. Nestor that a worker's claim to Social Security benefits is "noncontractual and cannot be soundly analogized to that of a holder of an annuity, whose right to benefits are [sic] bottomed [based] on his contractual premium payments . . . To engraft upon the Social Security system a concept of accrued property rights would deprive it of the flexibility and boldness in adjustment to ever-changing conditions which it demands."[23]

In other words, the future benefits of retirees are completely dependent upon future voters and politicians. Given the tax burden needed to fund promised benefits under the current system, it seems appropriate to assign a considerable degree of political risk to future Social Security benefits.

On Figuring the Private Rates of Return

Criticism: The rates of return on private investments assumed in the Heritage study are too high. This exaggerates the benefits of a privately held individual account.

Response: We used very cautious assumptions regarding the rates of return paid on private investments. For the years up to 1997, we used the actual annual historical rates of return on bonds and equities. For 1998 and future years, the real rate of return on equities was assumed to be 5.7 percent, and the real rate of return on bonds was projected to be 2.8 percent.

The 5.7 percent real rate of return on equities lies well below the long-term rates found in the professional literature. For example, the Social Security Administration's own 1994–1996 Advisory Council used a projected return of 7 percent on equities after considering a wide range of expert testimony.[24] During the 1926 to 1997 period, large company stock returns averaged 7.7 percent after inflation, while small company stocks yielded an average post-inflation return of 9.3 percent.[25] Heritage reduced even these returns on equities and used a return of 5.7 percent.

The 2.8 percent return on U.S. government bonds is the same as the long-term rate used by the Social Security Administration in the 1998 Report of the Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.

However, even if ultra-pessimistic predictions regarding the returns on stocks are adopted, the major conclusions of the Heritage study would be unaffected. One critic of the study cited a report by Dean Baker of the Economic Policy Institute[26] in which the claim was made that economic growth, as projected in the Social Security Trustees' Report (whose assumptions were used as the basis for the Heritage study), was consistent with a real rate of return on stocks of only 4.5 percentage points. Citing this rate of return on equities does not, however, indict the Heritage analysis: Our assumed rate of return is even lower, at a very cautious 4.25 percent. In the great majority of cases, returns from a private account exceeded returns from Social Security, even where taxes were invested wholly in ultra-low-risk U.S. government bonds.

In our study, we assumed that individuals were extremely risk-averse in their investment strategies and would concentrate their investments among low-yield, ultra-secure investments. The riskiest portfolio we used was one in which half of all investments were made in long-term government bonds and the remainder in a broad market equity index. The projected future rate of return on this portfolio is 4.25 percent, with the bond component returning only 2.8 percent annually.

On Administrative Costs and Private Rates of Return

Criticism: Administrative costs would eat up 1.5 percent to 2 percent of all private funds annually. This would remove much or all of the gains from privatization for most workers.

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[22] Garrett, "The Effects of Differential Mortality Rates on the Progressivity of Social Security."

[23] Fleming v. Nestor, 363 U.S. 603 (1960).

[24] Social Security Advisory Council, "Findings and Recommendations," Report of the 1994–1996 Social Security Advisory Council, Vol. I, January 1997, p. 35.

[25] Ibbotson Associates, Stocks, Bonds, Bills and Inflation, 1997 Yearbook (Chicago, Ill.: Ibbotson Associates, 1998).

[26] "Saving Social Security With Stocks; The Promises Don't Add Up," The Twentieth Century Fund, 1997. Also see Weisbrot, Flawed Assumptions, Fatal Errors.

Response: Heritage's first rate of return study did not consider administrative costs explicitly. Instead, these costs were taken into account implicitly through an assumption of extremely low rates of return on private assets. However, both a Social Security Administration study and empirical data show that administrative fees will be much lower than the critics' 1.5 percent to 2 percent projection. A study by the Actuary's Office for the 1994–1996 Social Security Advisory Council estimated that administrative costs for the Personal Security Accounts (PSA) plan, which would privatize a substantial part of Social Security, would be only 1.0 percent of fund assets.[27]

In actual practice, costs are even lower. A 1996 U.S. Department of Labor study showed that the administrative costs for private-sector, multi-employer defined contribution plans were only 0.82 percent of assets. The mean administrative cost for Standard & Poor's 500 Index mutual funds was lower still—0.39 percent, according to Lipper Analytical Services.[28] And the Thrift Savings Plan, a privatized retirement plan run by the federal government for its employees, has costs for its three funds that range from 0.08 percent to 0.10 percent.

These lower estimates are supported by data from Australia's privatized social security system, in which annual administrative costs average 0.8 percent of fund assets.[29] The structure of the plan is also important. Limiting investment options and creating larger investment pools will hold costs down. These are features of most privatization plans. Also, costs decline rapidly after the plan starts. For instance, administrative costs for the Thrift Savings Plan are 76 percent lower than they were when the plan began operations in 1988.[30]

One low-cost option would be to allow individuals to invest their Social Security taxes in the new 30-year Series I Savings Bonds, which currently pay a return of 3.3 percent over the inflation rate. These bonds can be obtained at virtually no cost, and they pay a substantially higher rate of return than does the current Social Security system.

On the Employer's Share of Payroll Taxes

Criticism: The Heritage study included not only the employee's share of taxes, but also those paid by the employer. This overestimates the costs of the program to workers.

Response: Glen Lane, district manager of the Social Security Field Office in Cedar Rapids, Iowa, was among those who criticized our inclusion of the employer's share of the Social Security tax burden in our study.[31] However, the "employer's share" of Social Security taxes is part of the total amount an employer expends on employee compensation, which includes the worker's wages and employer-provided benefits. The ascription of the term "employer's share" is an accounting label, rather than a meaningful distinction. In the absence of Social Security taxes, this money from the employee's paycheck would be available for the worker to invest in a private account or to use as an addition to take-home pay. As Dean Leimer, chief author of the Social Security Administration's own calculations of its rate of return, has noted:

In any event ignoring the employer share of the tax is clearly inappropriate, because it results in the comparison of benefits with taxes that are insufficient to fund those benefits; as a consequence, Social Security appears to be a much better deal than it actually is when all taxes required to fund the program are considered.[32]

On Judging Social Security's Effectiveness by Its Rate of Return

Criticism: The rate of return is not a proper measure of the effectiveness of the Social Security program. Rather, the system should be judged on social criteria, such as its success in reducing the poverty rate among the elderly.

Response: To be judged effective, a retirement social insurance program not only must protect all workers from the threat of poverty when they are elderly, but also must provide an efficient level of retirement income for the taxes paid. The rate of return measures the difference between the money that Social Security takes from

[27] David C. John and Gareth G. Davis, "The Costs of Managing Individual Social Security Accounts," Heritage Foundation Backgrounder No. 1238, December 3, 1998.

[28] Lipper Analytical Services, unpublished data, October 1998, available from the authors upon request.

[29] Insurance and Superannuation Commission, Bulletin, Australian Government Publishing Services, various issues.

[30] See Thrift Savings Plan at http://www.tsp.gov/features/tspcx.html#sub3.

[31] Glen Lane, "Don't Distort Benefits Offered by Social Security," Cedar Rapids Gazette, February 5, 1998.

[32] Dean Leimer, "A Guide to Social Security Money's Worth Issues," Social Security Administration, Office of Research and Statistics, Working Paper Series No. 67, April 1995.

a family and the money that the family receives from Social Security. A low or negative rate of return means that individual families are foregoing higher retirement income because Social Security is returning less to them than they could have accumulated had they been able to invest their payroll taxes in private accounts. When the rate of return from Social Security for lower-income workers is below the rate available from alternative investments, the program actually may add to poverty—or at least slow wealth accumulation—by reducing the resources available to a family over their lifetime.

The founders of Social Security recognized the importance of the program's rate of return. Arthur J. Altameyer, chairman of the Social Security Board from 1937 to 1946 and the first Commissioner of the Social Security Administration, argued against policies that would lead to the evolution of a social security system that robbed workers of the chance of higher lifetime incomes or a more elaborate safety net by subjecting them to rates of return below those available from private markets. As Altameyer stated in 1945,

Therefore, the indefinite continuation of the current contribution rate will eventually necessitate raising employees' contributions later to a point where future beneficiaries will be obliged to pay more for their benefits than if they had obtained this insurance from a private insurance company . . . I say it is inequitable to compel them to pay more under this system than they would have to pay to a private insurance company, and I think that Congress would be confronted with that embarrassing situation.[33]

On Payroll Tax Assumptions

Criticism: Heritage inappropriately assumes that if Social Security is not partially privatized, it will be restored to balance entirely by raising payroll taxes and that this tax increase will begin in 2015, a decade earlier than the Social Security actuaries project would be necessary.[34]

Response: There are several ways to balance the Social Security system within its current framework. In addition to increases in payroll taxes, Congress could cut benefits, increase the retirement age, and require all state and local government workers to participate. Each of these proposals would have a different impact on workers of different ages and income levels. For example, extending Social Security coverage to all state and local government workers would create a massive unfunded liability among existing state and local employee retirement funds that would have to be corrected either by cuts in payments to retired state and local employees or by increased taxes.[35]

In their calculations of the rate of return to the current system, Social Security's own actuaries used two assumptions to reflect the financial imbalance in the system. The first of these assumes that the system is balanced through across-the-board cuts in Social Security benefits. The second assumes that balance is achieved by increases in payroll tax rates. Dean Leimer, who authored SSA's rate of return calculations, found that the rate of return from Social Security for workers born between 1932 and 1975 is higher under a regime of payroll tax increases than in a scenario where benefit cuts are used to balance the system.[36] This higher return occurs because current workers bear the full costs of benefit cuts while bearing only a partial share of future tax increases.

We used one of the two assumptions adopted by Social Security in its examination of the current system, and the assumption that we selected for Social Security's rate of return was the one that yielded the higher rate of return. Had we chosen the assumption of reduced future benefits, the rate of return would have been even lower.

The Social Security trust funds are composed entirely of U.S. government bonds, which means they are a set of IOUs that one part of the federal government (the U.S. Treasury Department) has written to another branch of the federal government (the Social Security Administration). When the Social Security system starts taking in less money than it needs to pay its promised benefits (as it is scheduled to do

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[33] Quoted in Schieber, Rates of Return on Social Security Contributions. Also see I. S. Falk, "Questions and Answers on Financing of Old-Age and Survivors Insurance," memorandum to O. C. Pogge, Director, Bureau of Old-Age and Survivors Insurance, February 9, 1945, p. 13.

[34] Kijakazi, African Americans, Hispanic Americans and Social Security.

[35] See Robert J. Scott, Testimony Before the Social Security Subcommittee of the House Ways and Means Committee Concerning Mandatory Social Security Coverage of Public Employees, March 21, 1998.

[36] Leimer, "A Guide to Social Security Money's Worth Issues."

in 2013),[37] then the federal government as a whole will have to meet the shortfall. It can do this either by redeeming the IOUs in the Social Security trust fund (which would mean raising non-Social Security taxes or cutting non-Social Security spending) or by cutting promised Social Security benefits or raising payroll taxes.

In each case, Social Security participants will have to bear the burden of this shortfall through increased federal non-Social Security taxes, reduced federal non-Social Security spending, Social Security benefit cuts, or Social Security tax hikes. In making their projections, Social Security's actuaries merely assume that the IOUs in the trust fund are redeemed, and do not take into account the non-Social Security tax hikes and spending cuts that the rest of the federal government will have to implement should it repay these IOUs. The day of financial reckoning is easily within the lifetime of the baby boomers and their children. Unless Congress raises taxes or cuts benefits and other spending, the Social Security Trustees will begin calling in their loans to the U.S. Treasury by about 2012. By about 2030, the Trustees will have been paid back all of their loans and will have to begin making sharp reductions in Social Security's basic programs.

A LACK OF COMPETING ANALYSES BY OUR CRITICS

The criticisms leveled at Heritage's rate of return analysis have not succeeded in altering our finding: Social Security offers a very low rate of return for most Americans, including minorities and low-income families. Not only does a low rate of return reduce a family's potential retirement income, but it also diminishes the ability of families to pass wealth on to children.

That Heritage's major finding remains unrefuted is perhaps best underscored by the failure of any of its critics to publish their own estimates of Social Security's rate of return. In advancing their criticisms, neither the Center on Budget and Policy Priorities, nor the American Association of Retired Persons, nor Robert Myers, nor the Institute for America's Future has produced their own estimates of the rate of return for Social Security or the degree to which our estimate is affected by the alleged errors in its analysis.

However, one major question remains: Why has the Social Security Administration itself not published calculations of the impact of the current program (or any of the major reform alternatives) on minorities, especially in light of the fact that it readily answers rate of return questions based on age and income? This stunning silence is puzzling, given that Social Security constitutes the federal government's largest domestic program, that the mortality and income data required to complete such a study are readily available to federal researchers,[38] and that the impact on minorities of almost every other federal program has been subjected to extensive analysis.

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[37] Social Security Administration, 1998 Report of the Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.

[38] See Gareth G. Davis, "Ethnic and Racial Differentials from Social Security Old-Age and Survivors Insurance," unpublished essay, November 1998, available upon request from the author.

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Table 1 CDA98-08

SSA-Calculated Return for Low-Income Single Males Under Current System and Under PSA Plan

Birth Year	Current Law Social Security System	"Personal Savings Account" Plan	Increase in Return Under Private Account
1920	4.37%	4.37%	0.00%
1930	3.06	3.06	0.00
1937	2.66	2.66	0.00
1943	2.36	2.46	0.10
1949	2.43	2.40	-0.03
1955	2.45	2.46	0.01
1964	2.37	2.63	0.26
1973	2.32	2.95	0.63
1985	2.16	3.01	0.85
1997	1.95	3.00	1.05
2004	1.83	2.99	1.16

Source: 1994–1996 Social Security Advisory Council. Private Savings Account return scenario is based on a Social Security Administration analysis of projected returns from 401(k)-type investments and includes all transition costs. Current law scenario assumes payroll taxes are increased to fund promised benefits.

Table 2 CDA98-08

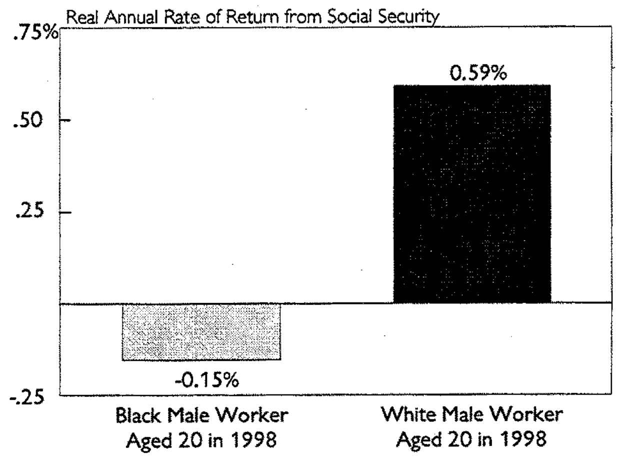
The Goss Expected Value Method vs. The Experience of Median Worker

	Years of Paying Taxes	Years of Receiving Benefits	Number of Tax Years Per Year of Benefits
Goss "Average" Method			
Black Male	39.1	8.1	4.8
White Male	42.2	12.1	3.5
Experience of 50th Person From a Population of 100			
Black Male	45	4.7	9.6
White Male	45	12.0	3.8

Sources: Steve Goss, Social Security Administration, "Problems with 'Social Security's Rate of Return: A Report of the Heritage Center for Data Analysis'", Memorandum dated February 4, 1998; Heritage calculations, based on National Center for Health Statistics, *Vital Statistics of the United States, 1992 Life Tables*, 1998.

Chart 1 CDA98-08

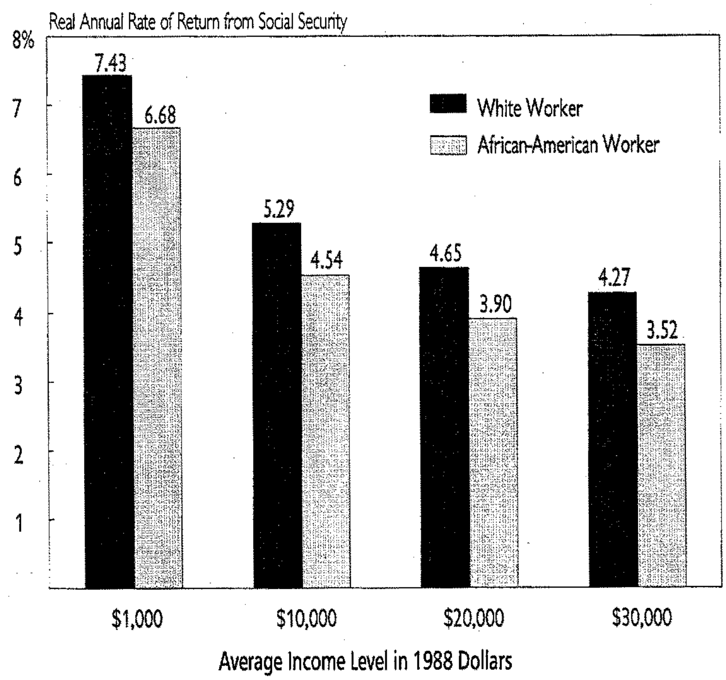
Real Rate of Return from Social Security for 20-Year-Old Males using "Expected Value" Method



Note: Based on National Center for Health Statistics, *Vital Statistics of the United States, 1992 Life Tables,* 1998 and data based on 1997 Social Security *Trustees' Report.* This analysis assumes current law benefits and taxes and utilizes "expected value" methodology.
Source: Heritage calculations based on data from Social Security Administration and National Center for Health Statistics.

Chart 2 CDA98-08

For Workers Born in 1918, Treasury Department Data Show That Social Security Offers African-American Workers Lowest Rate of Return



Source: Calculation based on data provided by Duggan *et al.* and published in Sylvester Schieber, *Rates of Return on Social Security Contributions: Good Deal, Bad Deal, or Do We Even Care?* testimony before the Senate Budget Committee, January 21, 1998.

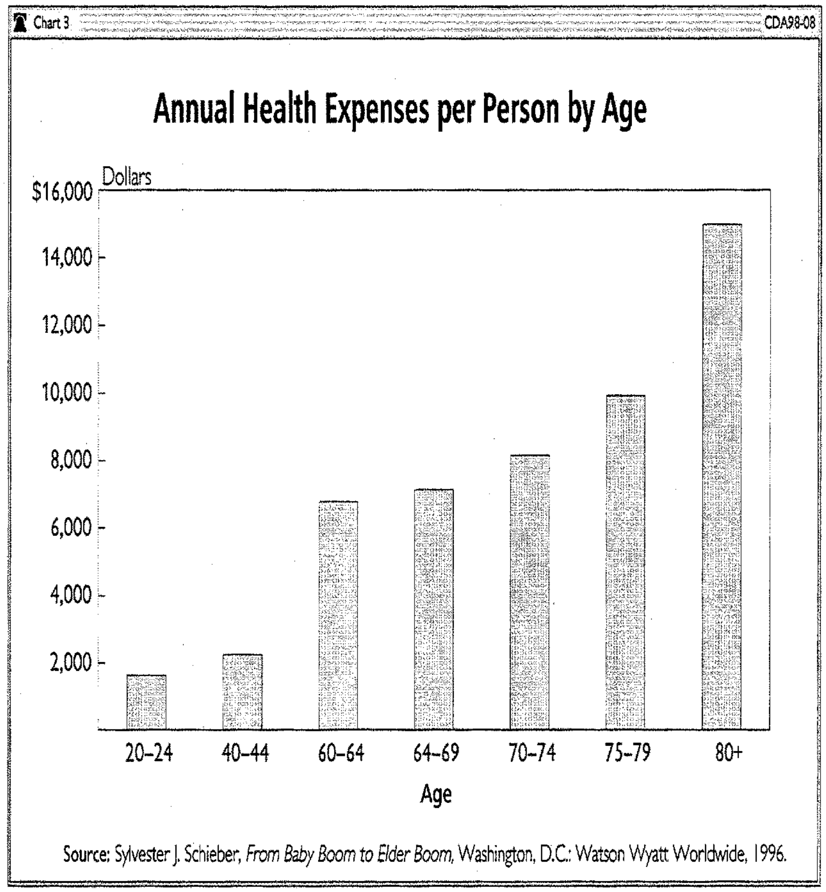


Chart 3
CDA98-08
Annual Health Expenses per Person by Age
Dollars
$16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
20–24
40–44
60–64
64–69
70–74
75–79
80+
Age
Source: Sylvester J. Schieber, *From Baby Boom to Elder Boom*, Washington, D.C.: Watson Wyatt Worldwide, 1996.

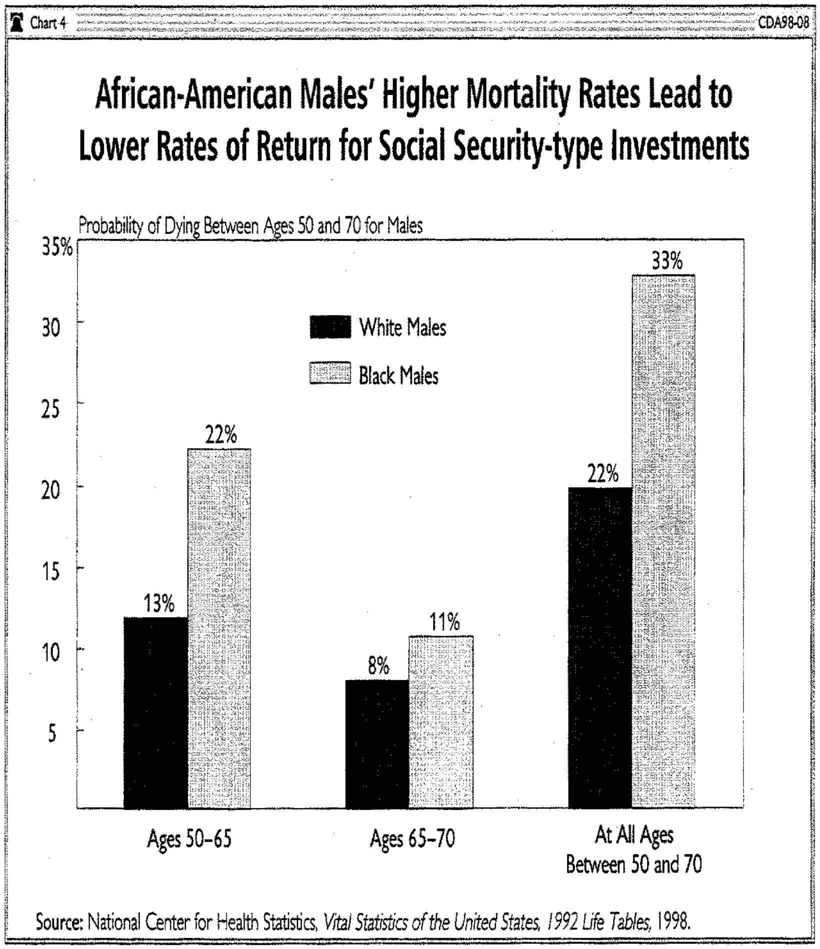
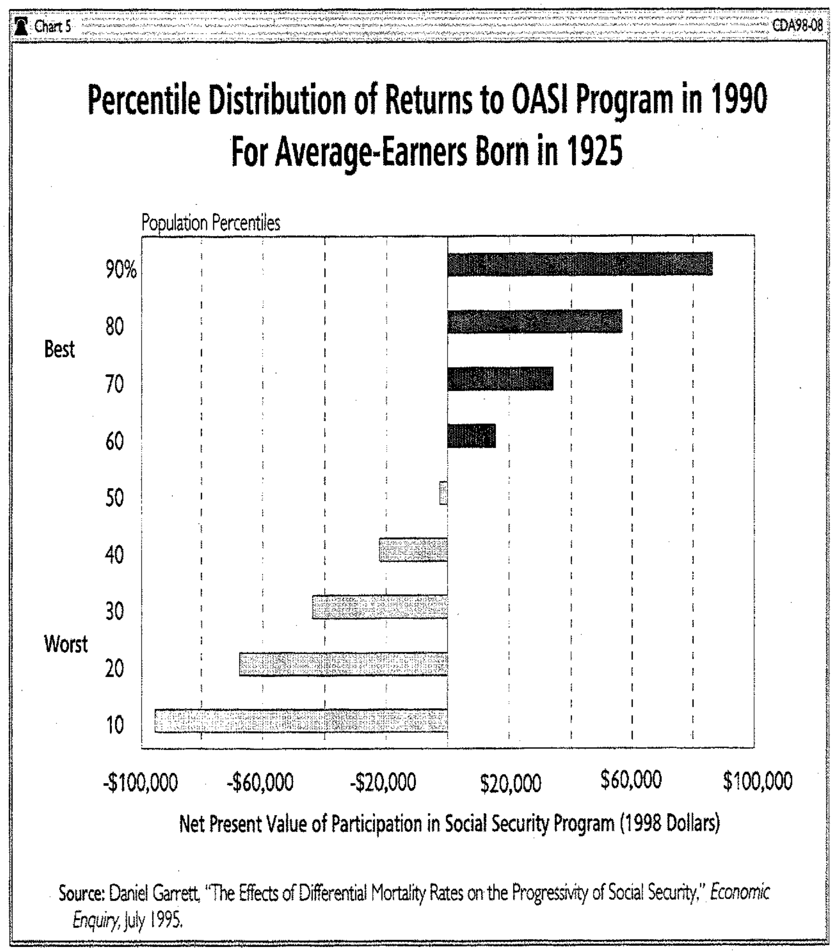


Chart 4
CDA98-08
African-American Males' Higher Mortality Rates Lead to Lower Rates of Return for Social Security-type Investments
Probability of Dying Between Ages 50 and 70 for Males
35%
30
25
20
15
10
5
White Males
Black Males
13%
22%
8%
11%
22%
33%
Ages 50–65
Ages 65–70
At All Ages Between 50 and 70
Source: National Center for Health Statistics, Vital Statistics of the United States, 1992 Life Tables, 1998.



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Mr. LEVIN. Let me just ask you this quickly: As I understand it, you want to take the nonretirement portions out of the picture and guarantee people who fall within those categories what they have today essentially in perpetuity. You don't have any idea of reshaping that program.

Mr. BEACH. That is not precisely correct.

Mr. LEVIN. It isn't?

Mr. BEACH. No. What I want to make certain is that we keep a focus during this debate on the retirement portion. Now, as you know, the Congress is looking at disability insurance and other things, is on a separate track——

Mr. LEVIN. Well, except, I mean, there are some suggestions—and I think worthwhile ones—about trying to allow people with disabilities to earn money, and so forth. So there would be greater moneys.

You would not basically change the disability program, right?

Mr. BEACH. Not in the work that we are doing right now on retirement. We want to hold that to one side for separate discussion.

Mr. LEVIN. That may scare people, too.

Mr. BEACH. Well, it is a very interesting and important program that is at great risk right now, and we should take seriously our obligations to make it work better.

Mr. LEVIN. I just want to make one other comment. It is said on your side that you accept the 62 percent figure. I think it is correct that one should do that, if you mean what the President does, you are going to use general revenues. If you are going to set aside 62 percent of the surplus for Social Security, you are going to use general revenues, too.

Mr. HULSHOF. Will the gentleman yield?

Mr. LEVIN. Yes, surely.

Mr. HULSHOF. Are you saying 62 percent of the unified surplus or are you talking about 62 percent of the FICA surplus?

Mr. LEVIN. The President is saying he is going to use 62 percent of the overall unified surplus, not of the Social Security surplus. So I think we need to be cautious when we attack the President for using general revenue moneys, because, as I understood the articulated position by some of you, you would do the same.

I yield back what I don't have.

Thank you. [Laughter.]

Chairman SHAW. I would just like to make a comment on that. The Chairman of the Full Committee made the statement that he would hold in reserve 62 percent of the surplus until such time as Social Security is saved. The figures, it is a question of working it through. It is also a question of working through a plan. It is also a question of what the return is, what percentage goes into equities. I mean, there are a lot of things to thrash out. A plan is not yet on the table. So it is very hard to disagree or agree with you, Mr. Levin.

Mr. LEVIN. That is what Chairman Archer said, and when he said it, I thought that was one interpretation.

Chairman SHAW. The President said—the President has committed a sum equal to 62 percent of the surplus, to put it into the Social Security Fund.

Mr. LEVIN. Right.

Chairman SHAW. The Chairman has said that he will hold that money in reserve until such time as the Social Security problem is solved. We don't know exactly what part of that is required.

While we are on that, before I call on the next questioner, I would like to just make a little bit of a point as to where we are. The Social Security Fund right now looks like this [indicating], and then it drops off like that [indicating]. Now what the President does, his plan takes this arrow or this line and puts it out to about 2055, somewhere around there. The critical point which everybody is missing in this entire debate, this is the point we have to look at, because what happens to the money? If you put 62 percent of the reserve into the Social Security Fund, what is the Social Security Fund supposed to do with it? They can go buy Treasury bills.

That is what they have got to do with it. That's the law; that is what the law says they have to do with it. That is nothing but IOUs of the Federal Government. When you start cashing in the IOUs is right in here, and that is when the taxes are going to go through the roof.

When we start getting out into these years [indicating], all of a sudden, you will find that our grandkids are going to have to be paying about 40 percent of what they earn in order just to take care of their parents. That is the disaster that is going to affect low- and high-income people, and that is the disaster that this Congress has a unique ability to avoid. That is what we have to do.

The question of criticizing the President or not criticizing, I compliment him for bringing the point or putting that position on the table, that equities do have a position in the Federal insurance program, and we are going to try to work with him from that standpoint, even though we don't agree exactly how he does it. That is what we are going to do, and I am not going to trash the President's proposal, but I think, in all honesty, we have to be very concerned as to what we are talking about, and keep the eye on the ball, and not be looking in the other direction. Because when you get down here, you are in deep trouble. So you don't even look down here. It is up here, what we have to avoid, and we have to take the position whether it's 2013 or 2016, but wherever that point is, that's the date we have got to move, and we have got to move it way down the line, because if we don't, our children are going to turn our pictures to the wall and curse us. That is the problem.

Mr. MATSUI. If the gentleman would yield, because this is a different subject than the one we are talking about. I would just submit to the gentleman—the gentleman has been very fair. He has not said anything particularly negative about the President's plan, and certainly that is appreciated by everybody, I think. But there are some that have suggested the President's plan is inadequate, and my suggestion is perhaps these people should come up with their own. If people don't like using the surplus, that is, a part of the on-budget surplus, then one ought to come up with their own plan, because that means——

Chairman SHAW. Well——

Mr. MATSUI [continuing]. If I could just finish—it would entitle benefit cuts or revenue increases, or a combination of both. People ought to step up to the plate, if that is what they support, because certainly we can't fight phantoms. We have to be able to have a discussion in good faith. But all we hear is double accounting, using the surplus, but no one says they want benefit cuts or increasing taxes. You have got a 2 percent of revenue shortfall over the next 35 years.

So I need to hear more. We all need to hear more. We just can't sit for the next 6 months trashing the President's program. You're not, but then come up with a proposal. But if you want benefit cuts or tax increases, say it, so then we can join the issue.

Chairman SHAW. Well, let me say it: We are not going to increase the taxes and we are not going to cut benefits, and we are going to come up with a plan. Bob, I would invite you to join me.

Mr. MATSUI. I have been suggesting that for months and months, but Chairman Archer first wanted the President to come out with one. He did; now he has; now you guys are saying it is not enough. But when are we going to sit down and roll up our sleeves, as you suggested, and maybe make some hard decisions?

Chairman SHAW. Mr. McCrery is back.

Mr. MCCRERY. Well, thank you, Mr. Chairman. I wasn't going to get involved in this. [Laughter.]

Chairman SHAW. I thought this was a good time to throw your name in. [Laughter.]

Mr. MCCRERY. Well, I have said before that I appreciate the President coming forward with his proposal. I think there are some good parts to his proposal, but I don't think there is anything wrong, Mr. Matsui, with us—in fact, I think we have the obligation to thoroughly examine the President's proposal and point out deficiencies as we see them, or as we appreciate them, in this proposal, and then work together to repair those deficiencies, and come up with a proposal that takes us not to 2055. In that sense, the President's plan is inadequate. He only gets us to 2055. We want to take it at least to 2075, and we hope even beyond that.

You are right, it is up to us to come up with the rest of the plan. I think the President, it would be swell if he would come up with the rest of the plan, and he may, but I don't think it is necessarily incumbent upon him to do that. I think he has gotten us off to a good start. He has given us some meat to talk over, and that is what we are doing here today. I appreciate the testimony of all these folks, who have helped us examine some of the aspects of the President's plan.

But I don't think that we necessarily have to put anything on the table or take anything off the table right now, except maybe payroll taxes. I think there is pretty much unanimity on not increasing payroll taxes. On the benefits side, I am not going to say right now I am not in favor of any kind of change in benefits, because it depends on how you define benefits, If we are talking about the age of retirement or things like that, I think all those ought to be on the table and we ought to discuss them in a reasonable, intelligent manner, and examine that. We may in the end discard them, but we ought not take any of that off the table immediately.

So, anyway, I do appreciate the testimony of the witnesses. I am sorry I had to run in and out and miss some of your testimony, but I have looked at your testimony. I encourage all of you to continue working with us here in the legislative branch, as well as with the administration, to try to arrive at some sort of consensus, because I don't think we are going to be able to solve this problem without consensus. Republicans can't do it; Democrats can't do it; the President can't do it; and Congress can't do it alone. In the end, I think we are going to have to all be together on the solution that we propose to the American people. So thanks for your input.

Chairman SHAW. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

Mr. Beach, is it correct that it would take a fourth of all our FICA taxes in order to accomplish the initial objective that you subscribe to of preserving the disability and survivors' insurance system?

Mr. BEACH. By all of the FICA taxes, do you count the part that goes to Medicare or only those parts that go to OASI and DI?

Mr. DOGGETT. Only OASDI.

Mr. BEACH. So a fourth would be about 3 percentage points?

Mr. DOGGETT. Approximately.

Mr. BEACH. Well, it sort of depends. I am not an expert on disability insurance. I would suggest that what we are getting right now with disability insurance is at least a half a point too little to keep the system fully funded. If there are transfer from OASI to DI over the next couple of years, as are planned, because DI goes into negative cashflow in about—what?—about 2 or 3 years, then that will keep the system afloat, but I wouldn't dispute—perhaps not a full fourth, but close to that.

Mr. DOGGETT. Approximately. And would the implementation of the universal savings accounts that President Clinton has proposed be consistent with your stated objective of increasing our national savings rate?

Mr. BEACH. We are having quite a nice debate in my office on that right now. I think what we will do is we will come down this way. The universal savings account, as you know, is a supplemental savings, and there is a match to that, and there is all of that. First of all, it looks like it is going to benefit most those people in middle income and the upper part of a little bit below the maximum taxable income. I don't think that that is really where the focus ought to be. We ought to be focusing on the low and moderate side, as I have defined it.

Second, we really believe there are structural changes that have to be made within the program. So when we say put a savings element within Social Security, that is where we want to keep our focus. Then we really do have some serious questions about the funding of that.

Mr. DOGGETT. Yes, sir. Well, I understand you have many other aspects of it that you think might be done in a better way, but, as proposed——

Mr. BEACH. It is a wonderful step forward.

Mr. DOGGETT. It is a step forward in increasing the national savings rate.

Mr. BEACH. Well, I will tell you something that President Clinton has done——

Mr. DOGGETT. Well, I would just like to get an answer to that question, if I might. Don't you agree that the universal savings accounts, as proposed, while there may be better alternatives and there may be ways that Congress could improve it, that it is consistent with your objective of increasing the national savings rate?

Mr. BEACH. I doubt that.

Mr. DOGGETT. You doubt that?

Mr. BEACH. Yes.

Mr. DOGGETT. OK. And with reference to your testimony, respecting the comments of my colleague, Mr. Matsui, you are one person who does advocate cutting benefits, aren't you?

Mr. BEACH. We are looking at the way other countries have handled this. For example, if you——

Mr. DOGGETT. Let me just get an answer to that question, if I might. When you talk about enacting a Social Security contract between the government and citizens, it is not a contract that would preserve the existing level of benefits——

Mr. BEACH. That is correct.

Mr. DOGGETT [continuing]. With a cost-of-living adjustment.

Mr. BEACH. That is correct.

Mr. DOGGETT. It is a benefit cut, is it not?

Mr. BEACH. If you are in a—I would like to give you a quick yes, but I will give you a quick answer. If you are in the system with a private account, there would be a proportional reduction in benefits in the future for, say, 80 percent of what you were scheduled. That is one way you can be sure to raise the national savings rate.

Mr. DOGGETT. For just your ordinary worker out there now, you are advocating a benefit cut——

Mr. BEACH. Well, actually, we are advocating an increase in their income.

Mr. DOGGETT. Well, you hope that that would be the effect of your plan, but it is a reduction in current benefits with cost-of-living adjustments that would be guaranteed?

Mr. BEACH. Well, the other part of Social Security, part B, as I have said, would continue to be there.

Mr. DOGGETT. I just need to know whether you——

Mr. BEACH. I think it is better to say it is an increase in their income and their wealth.

Mr. DOGGETT. That is your hope, but, as a part of that plan, the first step you have in the plan is to enact a contract that will reduce existing guaranteed benefits with cost-of-living adjustments; is that correct, sir?

Mr. BEACH. Incorrect.

Mr. DOGGETT. It is not correct?

Mr. BEACH. The first step is the institution of the private accounts.

Mr. DOGGETT. Well, it is an element of your plan, is it not, sir, to enact a Social Security contract that will reduce existing guaranteed benefits, including cost-of-living adjustments; is that correct?

Mr. BEACH. As I have said, and I direct to our principles, no change in benefits for current retirees, no change in future benefits for those near retirement. If you are in the plan, Congressman—and I don't mean to bear on your patience here—but if you are in the plan with a private account, in your 4 percent, you would have a proportional decrease in benefits for the amount that you are privatized, but not for the other side. That is what other countries have done.

Mr. DOGGETT. So it is correct, as to those workers, that would represent a reduction, a cut, in existing benefits and cost-of-living adjustments?

Mr. BEACH. I think it is about time somebody stood up and said this is the way that these things work.

Mr. DOGGETT. And you may well be correct; this is part of the national debate, and I am glad you are willing to stand up and do it, even though we may disagree on it.

Now, another principle you have is that no worker would be required to open a personal retirement account; is that correct?

Mr. BEACH. Yes. We would like to see——

Mr. DOGGETT. What would happen to those that don't volunteer?

Mr. BEACH. They would stay in the full system.

Mr. DOGGETT. Would they be guaranteed their cost-of-living adjustment?

Mr. BEACH. We hope that that would be the case.

Mr. DOGGETT. Well, do you hope, or is it a part of your plan, a vital part of your plan, to guarantee——

Mr. BEACH. You say, "our plan." We don't have that plan, but our principles would indicate that the plan we will support would be one like, say, Great Britain has, where they have got that guarantee in there, yes, for those that are in that portion of Social Security, that progressive——

Mr. DOGGETT. So under the plan you hope to design, every worker in this country, present and future, who wished to stay in a system with a guaranteed benefit and a cost-of-living adjustment would be assured that right?

Mr. BEACH. Yes.

Mr. DOGGETT. Thank you.

Then I would like to ask, time permitting, Mr. Rodriguez one question.

Mr. RODRIGUEZ. Surely.

Mr. DOGGETT. Is there time, Mr. Chairman?

Chairman SHAW. Go ahead.

Mr. DOGGETT. That is with regard to the 1998 survey that you mentioned concerning the discomfort of some Hispanic-Americans with dealing with banks and mutual funds, and the like. Some here advocate personal responsibility, which I agree, and I am sure you do, is a good concept. But as it applies here, what are the implications of that study for moving to individual accounts for Hispanic-Americans?

Mr. RODRIGUEZ. I think it clearly suggests that there are some serious barriers that need to be overcome—some of this was mentioned earlier—regarding financial education, so to speak, and outreach that needs to take place prior to any implementation of an individual development concept. I think this is a serious issue among the Hispanic community right now, who do not have very good relationships with financial institutions. In fact, many, many financial institutions are not located in Hispanic communities, and so there are some serious, serious obstacles in order for Hispanics to, at a minimum, take advantage of any individual accounts of any sort.

Thank you. Thank you, Mr. Chairman.

Mr. JOHNSON of Texas [presiding]. Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman. Though Chairman Shaw has stepped out of the room, I certainly want to commend him on the quality of these hearings that he has been conducting under his new leadership as Chairman of the Subcommittee. I have found them to be very helpful in many ways, particularly in learning how traditional Social Security discriminates, particularly against women and widows. I have also learned, with the various panels that we have had, that whether it is African-American or Latino or other communities, that there is diversity of opinion within the communities, conservative and liberal, and that has been enlightening as well.

So I really want to commend him for conducting these hearings, as we look at how do we save Social Security for the long term, for the next three generations, which is a goal I think we all share on both sides of the aisle. We have a real opportunity; thanks to the fiscal responsibility of this Congress over the last few years, we, of course, now have extra money. It has been nicknamed "the surplus." We are projecting to have $2.3 trillion in extra tax revenue over the next 10 years, extra money. Of course, the debate is, what are we going to do with it? It is burning a hole in people's pockets. They want to decide what to do with it. I think we all agree a majority would like to devote the majority of it to saving Social Security.

Last fall this House of Representatives passed a plan that would set aside 90 percent of the surplus to save Social Security, and the President, just a few weeks ago, says we only need 62 percent. So, at a minimum, I certainly agree that we should set aside a majority, at least 62 percent, of the surplus tax revenue for saving Social Security. Of course, the debate is then, what do we do with the rest? Do we spend it on new government programs or do we give it back? And do we give it back in an effort which helps bring simplicity and fairness to the Tax Code, and ending discrimination against married couples and family farmers and family businesses?

Also, can we use it to help eliminate another area of discrimination in the Tax Code, which is the discrimination against savings. We tax savings. We discriminate against those who set aside money for their own retirement. Because of that, of course, our Nation now has one of the lowest savings rates in the industrialized world, and that certainly is one area where we need to do better.

My hope, as we go through this process and look for ways of giving some of this extra money back, is that we look at ways we can increase the opportunity to save and reward savings, so that we reestablish that three-legged stool that FDR talked about over 60 years ago, expanding the opportunity to increase the amount you can put into your IRAs and your 401(k)s, and also doing something that I feel may be an area which would really benefit working women, as well as minorities and immigrants, and that is in creating something that I call a catchup IRA, to allow those who may be out of the work force for a while or in low-paying jobs to be able to make up contributions to their IRAs or their 401(k)s.

The theory is, those who are immigrants or many in the minority community or working women, working moms, either take time off, if they have kids at home, off the payroll, or they start out at low wages. When you start out at low wages, you are contributing less to Social Security, which affects your long-term benefits. Maybe later on, as you are moving up the economic ladder, you have more money, which may give you the opportunity, with higher income, to contribute more for your own personal savings.

I think of my own sister, Pat, with the catchup accounts; she and her husband, Rich, took time off—or excuse me, got married and they were both working. Now, a few years later, she took time off from working, being on a payroll, to be home with the kids, and for about five or 6 years, she was a full-time mom, and then when the kids were old enough, she went back to working and being on a payroll again. She wasn't working at home; she was working, collecting a paycheck. So she had more income, which allowed her to save more. I would like to see her have that kind of opportunity to make a catchup contribution, to make up that missed contribution to her IRA and 401(k).

I was wondering, from the perspective of the minority community which is represented today, how you feel we can accomplish some sort of catchup mechanism, if you have thought about that, to help minorities and working moms catch up when it comes to saving for retirement. I thought maybe we would start on the lefthand side, Mr. de Posada, and if each of you has a comment, I would appreciate your opinions and ideas.

Mr. DE POSADA. Part of the problem is that, currently, in low-income communities, particularly Hispanics, we are not talking about investments; we are not talking about savings. I think what is good about this discussion, particularly personal retirement accounts, is that it is bringing it into the discussion of savings and investments in the local communities, and particularly in those low-income areas. I think that this discussion, ultimately generating some kind of system where we can allow individuals to do this—because everybody keeps talking about how low-income people do not have the experience. Well, let's provide consumer education; let's provide some of this pooling with individuals, with organizations, and some of the other components, local governments. I think the discussion is going to at least lead us into that direction.

Mr. WELLER. Mr. Spriggs.

Mr. SPRIGGS. I hope that you are offering that as a way to structure what the President proposed as a universal savings account. I think that that idea that you have is intriguing. It makes more work for your Subcommittee, I think, but, as an economist, I think you are exactly right. What you are concerned about with savings is someone's permanent income. If you look at the caps that we put on ability to contribute to an IRA, you are looking at income in 1 year, and the cap prevents you from giving more in 1 year. As you rightly point out, the permanent income flow for that person has been affected by lots of things, and it would be nice to be able to adjust that equation to let someone, as you say, catch up.

The gap for low-income workers, though, is not having that match that a 401(k) would provide from their employer or a pension plan that would match something. So that is where I think the President's plan is useful in at least talking about the need to give these workers a match, because we don't have the private pension system.

So I would hope you would explore the idea. I think the basic philosophy behind it is correct, because you are aiming it at savings, but I would hope that it would be in the context of creating this third-legged stool. So that workers who sometimes find themselves in low-wage jobs and don't have access to a 401(k) or a 403(d) could then at some point roll it over, so that when they are eligible, they can then catch up as well.

Mr. WELLER. What I'm thinking, Mr. Spriggs, I think of those who start out at a minimum wage job, work a number of years, and then get the opportunity as a cement finisher or an operating engineer——

Mr. COLLINS. Or a truckdriver.

Mr. WELLER [continuing]. Or a truckdriver, where they are going to make a higher income, perhaps get an extra bonus at the end of the year, or are able to collect a lot of overtime, where they are able to make up that missed contribution, and it is a chance for them to set aside more without penalty, as currently they are penalized under our Tax Code. Currently, our Tax Code discriminates that extra savings, that opportunity. Of course, I am hoping that——

Mr. JOHNSON of Texas. The gentleman's time has expired. Mr. Collins.

Mr. COLLINS. I mentioned truckdriver because I am one.

Mr. Matsui, now that I have called your name, you didn't raise a point of personal privilege. [Laughter.]

The dialog with the President on Social Security actually began in December, when a number of us went over for a 2-day summit on Social Security, and had very interesting meetings, not only with the Commissioner and those who are very involved and concerned about Social Security, but we also had a very good meeting on the second day with the President himself.

The President told us that he was going to come forward with an idea, and basically, that is what we have. When he presented his budget, he presented a general idea of how to address Social Security. His idea incorporates the idea of setting 62 percent of, what people refer to as, surplus—I don't refer to it as surplus; I refer to it as a positive cashflow in certain areas of the budget, the unified budget—aside. We actually were able to resolve the Social Security situation.

As we move forward in the Congress, we, too, will be drafting a budget document. That budget document will reflect some type of general concept of how we will address Social Security budgetwise. Some have said 62 percent, but there are some of us who feel like that all trust funds should be set aside, because those trust funds are encumbered, and someday they will have to be paid out in some type of benefit—as well as setting aside all of the interest that is owed through the government securities that are held by the general fund, to set those aside, too.

Now when you do that, disassemble that unified budget, we cease to have a positive cashflow in the overall budget. Even under the budget that was proposed by the President, and I would not be at all surprised if the Budget Committee that we have does not come back with something very similar, but it increases the national debt year after year. I think a lot of people are concerned at home about the national debt, as well as they are about Social Security, because if we keep increasing the national debt, people know that we are using a lot of those trust funds to cover that deficit spending. So there are some of us who believe that we should totally set aside all of those funds and the interest that accrued on those funds.

Mr. Matsui, were you listening to me?

Mr. MATSUI. I have heard every word you said.

Mr. COLLINS. But I haven't said them to you directly, and I was talking to you directly, and you were reading while I was talking. I'm sorry, I won't bother you again.

Mr. MATSUI. I know you were talking to me, and I just thought you were just wasting your time.

Mr. COLLINS. I probably was, but I thought it needed to be said, and I would appreciate the courtesy, when I do address you directly, that you do listen. I mean, I would do you that way.

Mr. MATSUI. Well, you know, I only listen when it is important.

Mr. COLLINS. Do you know the difference of what is important and what is not?

Mr. MATSUI. When you speak, I certainly do.

Mr. COLLINS. I do, too.

I yield back.

Mr. JOHNSON of Texas. We thank the panel for being with us today. We appreciate your testimony, and I hope we can count on you when we need you again. Thank you so much for being here.

The next panel can take their places, please: Patricia Owens from UNUM Life Insurance Co. of America; Marty Ford with the Consortium for Citizens with Disabilities; Dr. Ruth Hughes from the Psychosocial Rehabilitation Services in Maryland, and Dr. Burkhauser with Cornell University.

Please take your seats.

Chairman SHAW [presiding]. Ms. Owens, evidently, I missed something interesting.

STATEMENT OF PATRICIA M. OWENS, SENIOR DISABILITY ADVISOR, UNUM LIFE INSURANCE COMPANY OF AMERICA, BROOKLYN, NEW YORK

Ms. OWENS. Mr. Chairman, thank you for inviting me to give my views to this distinguished Subcommittee about Social Security's role in protecting people against the threat of disability. I am going to be talking to you from a programmatic perspective, and not necessarily from a financing one.

My remarks center on disability and working-age persons, for which I use the term "work disability." The Social Security Disability Program, SSDI, uses a very strict work disability definition. There are many other such definitions which, when met, qualify persons for cash and services. The basic premise under all of these programs is that persons need protection against the risk of being unable to work because of a disability, and that—and this is an important thing I didn't have in my written comments—and that disability can, in large part, be medically determined. That is a piece of all of these programs.

Now I will switch a minute. The enactment of the Americans with Disabilities Act, the ADA, grants certain rights to working-age people with disabilities. For one, they have the legal right not to be discriminated against in the course of employment because of their disability, if they can perform essential functions of work with or without reasonable accommodation. The basic premise of the ADA is that some persons with disabilities can and want to work. These provisions of cash benefits in lieu of wages under SSDI and the articulation of equal rights in employment for persons with disabilities under the ADA illustrate the remarkable heterogeneity of the term "disability." Two persons with the same level of impairment, one may be seeking benefits in lieu of work, and one, equal rights and employment.

For the last 20-plus years—I hate to say that—I have been working in the disability policy field, first in the public sector, and now in the private sector. When I was Associate Social Security Commissioner for Disability, during the development and the enactment of the 1984 disability amendments, and testified in front of you, Mr. Matsui, I learned some very important lessons. Deciding if a person's impairment or medical condition prevents work is a judgment based on finding of facts, but is not fact alone. There is no one set of rules that can cover or be uniformly applied to all potential interactions of persons' illness, injury, motivation, skills, education, environment, health care, work, that sort of thing. It is a very difficult type of thing.

Having said that, however, the Social Security Disability Program, in my opinion, has generally done a very good job. Without this program, many people with work disabilities, and their families, would be destitute. It is the framework upon which most private sector programs, with which I am now more familiar, are built. But it is not without its problems, nor the problems without their solutions. What I am encouraging us to think about with the disability program is not in relationship to financing alone, but in relationship to how the disability program is designed.

SSDI, in practice now, is an all-or-nothing program. While incentives for return to work exist, we all know the figure; less than one-half of 1 percent of people actually do return to the disability rolls. Because it often takes an inordinate amount of time to get on disability and to prove disability, it is no wonder that people actually believe they are totally disabled by the time they get through the system.

The point is that it is a very difficult kind of program. For many older, unskilled workers whose work history consists only of heavy labor, there just are not enough jobs available for them in today's job market, unless they can acquire new skills.

Then we have the point of after 2 years comes Medicare, the health insurance portion for persons with disabilities, and sometimes people, after they have gone through the system, all the way through the system through the ALJ, they almost get Medicare at the same time that they get their disability benefits.

The possibility of the loss of Medicare, the possibility of not being able to successfully go back to work, is a very difficult threat to persons who currently qualify for disability.

When the SSDI benefit program was conceived in the fifties, jobs available in the national economy were very different. The health care system was very different also. The nature of treatments and their effectiveness are now greatly altered, and we also have assistive technology, which is important.

In the last 40 years, work and the workplace have changed from industrial to service settings; work at home is increasing; many jobs require mental skills, reasoning, decisionmaking, the ability to work under pressure, not heavy lifting. Computing skills are practically mandatory for a majority of jobs. Mergers and downsizing are commonplace and bring a reduced sense of job security.

In the fifties acute illness and injury were the primary health care concerns. Today we see more chronic disease, where advanced treatment techniques enable people to maintain or regain capacity to work. Assistive devices can also help with this. Preventing death occurs more frequently, but often those saved have remaining impairment. Currently, psychiatric conditions, as a cause of disability, are in the ascendancy.

Health and disability programs in the private sector suggest ways for Social Security to move toward a less permanent benefit structure for more people, not for all people, but for more people, to help people transition back to work, and at the same time improve long-term financing.

Examples of these programs are—and I will be very quick—case management that recognizes disability is not a static state for many people; setting recovery expectations and working with people to bring together all available resources can help people get back to work.

In contrast, SSDI, after making a disability decision, does not systematically manage any case to assist in return-to-work efforts. Benefit structures and entitlement periods are set up in the private sector to encourage return to work. There is short-term disability. There are different types of disability periods. Some private sector disability programs reduce benefits and relationship to a staged reentry into the workplace.

Health care is an essential element of an effective disability program. It is a broad continuum of services directed at prevention, illness, and maximizing function. Presently, Medicare and Social Security do not work together in any way in relationship to the disability program and getting people back to work. We need to think about that.

Partnerships with other interested parties, currently, a lot of people are looking at this—the independent living center movement goal is to enable persons with disabilities. All of us need to work together to find and deliver better solutions than just permanent cash benefits.

These solutions must recognize there is no simple answer for the complex work disability. Incentives for training and job placement for both employer and employees is just one idea that could be helpful.

Chairman SHAW. Ms. Owens, I am going to ask you to put the balance of your statement on the record, if you would.

Ms. OWENS. OK, this is it; this is the last paragraph.

Chairman SHAW. Go right ahead.

Ms. OWENS. SSDI is, for some, the only and the right answer; for others, it is a building block on which other programs must rest. However, as the nature of illness and injury change, as work and the workplace changes, as people change, so must the program. I know you are concerned with other things about Social Security, but I hope that you will look at this also.

[The prepared statement follows:]

Statement of Patricia M. Owens, Senior Disability Advisor, UNUM Life Insurance Company of America, Brooklyn, New York

Mr. Chairman, thank you for inviting me to give my views to this distinguished committee about Social Security's role in protecting people against the threat of disability. I will discuss this from a programatic rather than a financing view.

My remarks center on disability in working age persons for which I use the term work disability. The Social Security Disability Program (SSDI) uses a very strict work disability definition. There are many other such definitions which when met, qualify persons for cash and services. The basic premise under all of these programs is that persons need protection against the risk of being unable to work because of disability and that disability can be in large part medically determined.

The enactment of the Americans With Disabilities Act (ADA) grants certain rights to working age people with disabilities. For one, they have the legal right not be discriminated against in the course of employment because of their disability, if they can perform the essential functions of work with or without reasonable accommodation. The basic premise of the ADA is that some persons with disabilities can and want to work.

These provision of cash benefits in lieu of wages under SSDI and the articulation of equal rights in employment for persons with disabilities under the ADA illustrate the remarkable heterogeneic nature of the term disability. Of two persons with the same level of impairment, one may be seeking benefits in lieu of work and one, equal rights in employment.

For the last twenty years I have been working in the disability policy field, first in the public sector and now in the private sector. As Associate Social Security Commissioner for Disability during the development and enactment of the 1984 Disability Amendments, I learned some important lessons.

Deciding if a persons' impairment or medical condition prevents work is a judgement based on a finding of facts but is not fact alone. No one set of rules can cover or be uniformly applied to all the potential interactions of persons, illness, injury, motivation, education, skills and environment.

Having said that, the Social Security Disability Program, in my opinion generally has done a good job. Without this program, many persons with work disabilities and their families would be destitute. It is the framework around which most private sector programs are built. But, it is not without problems, nor are the problems without solutions.

SSDI is an all or nothing program. While incentives for return to work exist, we all know this figure,—less than one/half of one percent of beneficiaries return to work. Because it often takes an inordinate amount of time and effort to prove disability (inability to do any work), it is not surprising that when the system finally awards benefits to people, they may believe themselves permanently unable to work. It is also not surprising that persons with SSDI fear having to go through the ordeal again if a return to work effort fails.

For many older, unskilled employees whose work history consists only of heavy labor, there just aren't jobs available for them in today's job market unless they can acquire new skills.

After two years of SSDI entitlement, beneficiaries acquire health insurance—Medicare. (In 1996 nearly one quarter of all disability awards were made by an Administrative Law Judge so Medicare may be almost simultaneous for these workers as it may take two years to get a favorable decision.) The possibility of the loss of Medicare or lesser health care coverage frightens people who have medical conditions because most believe they will not get health insurance for pre-existing conditions. If they do get coverage, costs may be prohibitive.

When the SSDI program was conceived in the nineteen fifties, jobs available in the national economy were very different. The health care system too, was different. The nature of treatments and their effectiveness are now greatly altered. Assistive technology provides ability to work for many persons today.

In the last 40 years, work and the work place have changed from industrial to service settings. Work at home is increasing. Most jobs require mental skills, reasoning, decision making, ability to work under pressure, not heavy lifting. Computing skills are practically mandatory for a majority of jobs. Mergers and downsizings are common place and bringing a reduced sense of job security.

In the fifties, acute illness and injury were the primary health care concern. Today, we see more chronic disease where advanced treatment techniques (and assistive devices) enable persons to maintain or regain the capacity to work. Preventing death occurs more frequently but often those saved have remaining impairment. Currently, psychiatric conditions as a cause of disability are in the ascendancy.

Health and disability programs in the private sector today suggest ways for Social Security to move toward a less permanent benefit structure for more people, help people transition back to work and at the same time improve long term financing. Examples of these programs are:

> Case Management that recognizes disability is not a static state for many. Recovery expectations including positive return to work goals are set up front and a plan is followed to assure all available resources are used to assist in recovery of function and return to work. Case management starts early and provides for gradual return to work. In contrast, SSDI

after making a disability decision, does not systematically manage any cases to assist in return to work efforts.

Benefit structures and entitlement periods that are set up to encourage return to work. Some private sector disability programs reduce benefits in relationship to a staged re-entry into the work place and wages earned.

Health Care as an essential part of an effective disability program. Health care is a broad continuum of services directed at prevention of illness and injury and maximizing function not just treatment of disease. Health care providers must be educated to their responsibility to help patients return to a productive life. Presently, Medicare and Social Security Disability Programs are not synchronized with prevention services and treatment outcomes.

Partnerships with other interested parties, (insurers, employers, academicians, health care providers, engineers) to find and deliver solutions that are better than permanent cash benefits for some persons. These solutions must recognize that there is no one answer for the complex work disability. Incentives for training and job placement for both employer and employee is just one idea to be further honed.

SSDI is for some the only and the right answer. For others, it is a building block on which other programs rest. However as the nature of illness and injury change, as work and the work place change, as people change—so must the program if it is to continue as a meaningful protection against disability by providing a range of relevant benefits and services.

—

Chairman SHAW. Thank you, Ms. Owens.
Ms. Ford.

STATEMENT OF MARTY FORD, ASSISTANT DIRECTOR, GOVERNMENTAL AFFAIRS, ARC OF THE UNITED STATES; AND COCHAIR, SOCIAL SECURITY TASK FORCE, CONSORTIUM FOR CITIZENS WITH DISABILITIES

Ms. FORD. Chairman Shaw and Members of the Subcommittee, thank you for this opportunity to discuss the Social Security system's solvency issues from the perspective of people with disabilities.

People with disabilities have a stake in Social Security reform. We believe that the title II, Old-Age, Survivors, and Disability Insurance Programs are insurance programs, not investment programs, designed to reduce risk from certain specific or potential life events, for the individual. They insure against poverty in retirement years. They insure against disability limiting an individual's capacity to work, and they insure dependents and survivors of workers who become disabled, retire, or die.

In fact, more than one-third of all Social Security benefit payments made monthly are to people who are nonretirees. People with disabilities benefit from the title II trust funds under several categories of eligibility. They include, obviously, disabled workers, but also retirees and, I would like to point out, adult disabled children who are dependents of disabled workers and retirees and, also, adult disabled children who are survivors.

People with disabilities cannot be easily separated out of the debate. For instance, adult disabled children receive benefits from their retirement and survivors' programs based on the work history of their parents.

The nature of the OASDI Programs as insurance against poverty is essential to the protection of people with disabilities. The programs provide benefits to multiple beneficiaries across multiple generations under coverage earned by a single wage-earner's contributions.

Partially or fully privatizing the Social Security Trust Funds would shift the risks that are currently insured against in title II from the Federal Government back to the individual.

Plans which spend the current or projected Social Security Trust Funds on building private accounts would be devastating for people with disabilities, and we oppose them.

We believe we have a system that works. We believe that Congress should only consider legislation that: maintains the basic structure of the current system, based on workers' payroll taxes; preserves the Social Security Disability, Survivors, and Retirement Programs; guarantees benefits with inflation adjustments; and preserves the Social Security Trust Funds to meet the needs of current and future beneficiaries.

Certainly, changes will be necessary within the basic structure to bring the program into long-term solvency. However, those changes must not be so drastic as to undermine or dismantle the basic structure of the program.

I need to point out that many privatization proposals try to address the very high transition costs associated with privatization through very deep cuts in the current program. In addition, although some solvency proposals claim to leave disability benefits untouched, they actually include elements that will hurt people with disabilities. Proposals that claim to offset cuts by the creation of individual accounts ignore the fact that many people with disabilities are significantly limited in their ability to contribute to those accounts for themselves and their families.

In my full testimony, I have highlighted some basic components of the major proposals that could have a negative impact on people with disabilities. These are provided to assist in understanding how people would be affected, and they include the potential impact of changes to the benefit formula, privatization of retirement and survivors only, the whole issue of annuities and how they affect adult disabled children, and the issue of increased risk and capacity to manage accounts.

To assist the Subcommittee—and, indeed, all parties to the debate—we urge the Subcommittee to follow through on a suggestion made at an earlier hearing at Full Committee, to request a beneficiary impact statement from SSA on every major proposal or component of a proposal under serious consideration. In a program with such impact on millions of people of all ages, it is simply not enough to address only the budgetary impact of change. The people impact must also be studied and well-understood before any change is initiated. For our constituency, people with disabilities, their very lives depend on such analyses.

Again, I thank the Subcommittee for considering our viewpoints on these critical issues. People with disabilities, and their families, will be vitally interested in the Subcommittee's work, and we pledge to work with you in developing solvency solutions.

Thank you.

[The prepared statement follows:]

Statement of Marty Ford, Assistant Director, Governmental Affairs, ARC of the United States; and Cochair, Social Security Task Force, Consortium for Citizens with Disabilities

Chairman Shaw and Members of the Subcommittee, thank you for this opportunity to discuss the Social Security system solvency issues from the perspective of people with disabilities.

I am Marty Ford, Assistant Director for Governmental Affairs of The Arc of the United States, a national organization on mental retardation. I am here today in my capacity as a co-chair of the Social Security Task Force of the Consortium for Citizens with Disabilities.

The Consortium for Citizens with Disabilities is a working coalition of national consumer, advocacy, provider, and professional organizations working together with and on behalf of the 54 million children and adults with disabilities and their families living in the United States. The CCD Task Force on Social Security focuses on disability policy issues and concerns in the Supplemental Security Income program and the disability programs in the Old Age, Survivors, and Retirement programs.

For more than 60 years, the Social Security program has been an extremely successful domestic government program, providing economic protections for people of all ages. It works because it speaks to a universal need to address family uncertainties brought on by death, disability, and old age. The Social Security system has evolved to meet the changing needs of our society and will have to change again in order to meet changing circumstances in the future. However, any changes must preserve and strengthen the principles underlying the program: universality, shared risk, protection against poverty, entitlement, guaranteed benefits, and coverage to multiple beneficiaries across generations.

PEOPLE WITH DISABILITIES HAVE A STAKE IN SOCIAL SECURITY REFORM

The Title II Old Age, Survivors, and Disability Insurance (OASDI) programs are insurance programs designed to reduce risk from certain specific or potential life events for the individual. They insure against poverty in retirement years; they insure against disability limiting a person's ability to work; and they insure dependents and survivors of workers who become disabled, retire, or die by providing a basic safety net. While retirement years can be anticipated, disability can affect any individual and family unexpectedly at any time.

People with disabilities benefit from the Title II trust funds under several categories of assistance. Those categories include: disabled workers, based on their own work histories, and their families; retirees with benefits based on their own work histories; adult disabled children who are dependents of disabled workers and retirees; adult disabled children who are survivors of deceased workers or retirees; and disabled widow(er)s.

More than one-third of all Social Security benefit payments are made to 16.7 million people who are non-retirees, including almost 4.7 million disabled workers, nearly 1.5 million children of disabled workers, about 190,000 spouses of disabled workers, and 713,000 adult disabled children covered by the survivors, retirement, and disability programs. Other non-retirees include non-disabled survivors and dependents. For the average wage earner with a family, Social Security insurance benefits are equivalent to a $300,000 life insurance policy or a $200,000 disability insurance policy.

Beneficiaries with disabilities depend on Social Security for a significant proportion of their income. Data from the Census Bureau's Current Population Survey indicates that, in 1994, the poverty rate for working age adults with disabilities was 30 percent. The recently conducted National Organization on Disability—Harris Poll revealed significant data on employment of people with disabilities: 71 percent of working age people with disabilities are not employed, as compared to 21 percent of the non-disabled population. The capacity of beneficiaries with disabilities to work and to save for the future and the reality of their higher rates of poverty must be taken into consideration in any efforts to change the Title II programs.

I. MAINTAINING OLD AGE, SURVIVORS, AND DISABILITY INSURANCE AS INSURANCE PROGRAMS

The nature of the OASDI programs as insurance against poverty (for survivors; during retirement; or due to disability) is essential to the protection of people with disabilities. The programs are unique in providing benefits to multiple beneficiaries and across multiple generations under coverage earned by a single wage earner's contributions. Proposals that partially or fully eliminate the current sharing of risk through social insurance and replace it with the risks of private investment will be harmful to people with disabilities who must rely on the OASDI programs for life's essentials, such as food, clothing, and shelter, with nothing remaining at the end of the month for savings and other items many Americans take for granted.

Privatization of the Social Security trust funds would shift the risks that are currently insured against in Title II from the federal government back to the individual. This could have a devastating impact on people with disabilities and their families as they try to plan for the future. The basic safety nets of retirement, survivors, and disability insurance would be substantially limited and individuals, including those with limited decision-making capacity, would be at the mercy of fluctuations in the financial markets. In this document, the use of the term privatization does not include the proposals for the federal government to invest a portion of the trust funds in the private market. Those proposals contemplate shared investment with no shift of the risks from the government to the individual.

In addition, solvency plans which are likely to produce substantial pressure on the rest of the federal budget in the future could have negative impact on people with disabilities, ultimately reducing the other services and supports upon which they also must rely. Plans which spend the current or projected Social Security trust fund surpluses on building private accounts would have such negative results. Plans which create private accounts from non-Social Security surpluses, though promising, must be weighed against other priorities, such as preserving Medicare.

In short, we believe that Congress should only consider legislation that maintains the basic structure of the current system based on workers' payroll taxes; preserves the social insurance disability, survivors, and retirement programs; guarantees benefits with inflation adjustments; and preserves the Social Security trust funds to meet the needs of current and future beneficiaries. Certainly, changes will be necessary within the basic structure to bring the trust funds into long-term solvency. However, those changes must not be so drastic as to undermine or dismantle the basic structure of the program.

II. Effects of Proposals to Privatize and to Pay for Privatization

Many proposals try to address the very high transition costs associated with privatization through deeper cuts in the current program; these cuts could negatively affect people with disabilities. In addition, many solvency proposals claim to leave disability benefits untouched. However, as described below, these plans include elements that will seriously hurt those with disabilities. Further, proposals that claim to offset cuts in the basic safety net by the creation of individual accounts based on wages ignore the fact that many people with disabilities are significantly limited in their ability to contribute to those accounts for themselves and their families.

Following are some basic components of the major proposals that could have a negative impact on people with disabilities. These must be critically analyzed since the combined effects of the provisions may push many people with disabilities and their families into or further into poverty.

Changes to the Benefit Formula—A common element in several reform plans is a modification to the benefit formula so that the Primary Insurance Amount (PIA) is lower. This change also would cut disability benefits since they, like retirement benefits, are based on the PIA. Such a modification would reduce disability benefits from 8 to 45 percent or more, depending on the plan, with some of the major proposals resulting in cuts of 24 to 30 percent. Reducing the PIA would force more people with disabilities further into poverty.

Access to Retirement Accounts—Under most plans, disabled workers younger than age 62 would not have access to their individual investment account to offset the cuts created by changes to the benefit formula. About 85 percent of disabled workers are below age 62 and would have to make up for lower disability benefits with their own resources, which may be limited, until age 62. In addition, those adult disabled children who are substantially unable to earn a living or save for retirement, or those workers who are disabled early in their work years, could have no individual retirement account to access, even if allowed, and could have little to no personal assets to supplement benefits.

Conversions from Disability to Retirement/Adequacy of Accounts—Upon reaching normal retirement age, disabled workers (DI program) convert from disability to retirement benefits. At this point, disabled workers could find their individual accounts are inadequate because the proceeds from individual accounts would necessarily be limited by the fact that, while disabled and not working, no additional contributions could have been made. If the disabled worker were able to work, earnings would likely be lower than average. Therefore, the disabled worker would have far less accrued (in both principal and investment return) than had s/he been able to contribute throughout their normal working years or been able to contribute at higher rates due to higher earnings. Yet, Social Security benefits also would have been reduced due to changes in the benefit formula. In addition, there would be a substantial number of adult disabled children who would have no accounts or minimal accounts at retirement age.

In addition, for each worker, there would be only one individual account. Now, Social Security will pay benefits to spouses, children, adult disabled children, surviving spouses, and former spouses. Under individual account proposals, those accounts would have to be divided among, or may be unavailable to, those who can now get benefits.

Computation of Years of Work—The proposals to extend the computation period for retirees could hurt those people with disabilities whose condition or illness forces a reduction in work effort (with resulting lower earnings) in the years prior to eligibility for disability benefits. These proposals would increase the number of years of earnings that are taken into account in deciding the individual's benefit amount. Essentially, the number of years of "low" or "no" earnings that are now dropped in the computation would be reduced; thus, the years of low and no earnings that people with disabilities may experience prior to eligibility for disability benefits would have a more substantial effect on the individual's average earnings when computing their retirement benefits.

Maintaining the purchasing power of benefits—Social Security benefits are adjusted for inflation so that the value of the benefit is not eroded over time. Some proposals would reduce annual cost-of-living adjustments (COLAs) by arbitrary amounts. These arbitrary reductions cumulate over time so that a 1 percent reduction in the COLA would result in a 20 percent reduction in benefits after 20 years. For people with disabilities who must rely on benefits from the OASDI system for a substantial period of time, cuts could be devastating. It is critical that benefits be set at meaningful levels to support such individuals and that appropriate COLAs be included to ensure that the purchasing power of the benefit is not reduced over time.

Raising the Normal Retirement Age (NRA)—Raising the normal retirement age could create an incentive for older workers to apply for disability benefits in two ways. (1) If only the NRA is increased, the early retirement age benefit would be reduced to a greater degree than under current law (reflecting the actuarial reduction in benefits based on drawing benefits for a number of years earlier than NRA). Disability benefits, unless similarly reduced, would then become more attractive to older workers. (2) For many of those in hard, manual labor jobs who simply can no longer work at the same level of physical exertion, leaving the workforce before NRA will be necessary. Many would apply for disability benefits. These added pressures on the disability insurance program (to make up for changes in the retirement program) would increase costs and potentially create political pressure for more drastic changes in the disability program based upon its "growth."

Privatization of Retirement and Survivors Only—Some privatization proposals claim they privatize retirement and survivors protection but leave disability protection alone. There would be no intended direct effect on the disability insurance program. However, those adult disabled children who depend upon retirees' dependent benefits or upon survivor's benefits would be directly negatively affected. The private accounts of the parents are unlikely to be adequate to provide basic support to adult disabled children for the rest of their lives, perhaps decades after the parents' deaths (especially if the parents were themselves dependent on the private accounts for any length of time before death) and some plans would require the parents to purchase annuities. Under plans where a deceased worker's funds go to the estate, there is no assurance that, upon distribution of the estate, the adult disabled child would be adequately protected for the future. Under some plans, funds are transferred to the worker's surviving spouse's account; again, there is no protection of the adult disabled child.

Annuities—Where retirees are required to purchase annuities with individual account proceeds (as some plans require), no funds would be available for the surviving adult disabled child when the retiree dies. Again, the adult disabled child may live for decades after the death of the parent; the annuity approach makes no plans for these dependents/survivors.

Opting Out of the System—One proposal which allows individuals to opt out of the system would require those who opt out to purchase disability insurance. Whether this insurance would be comparable to the current disability insurance system is unknown; currently, there is no insurance comparable to Social Security disability benefits which includes indexing for inflation and coverage of family members. In addition, as the disability community well knows, disability insurance (or for that matter, health or other insurance) is essentially non-existent for most people who already have disabilities. Also, there is no guarantee of support through this means for dependents or survivors with disabilities.

Flat Retirement Benefit—One proposal would replace the benefit formula with a flat retirement benefit ($410 in 1996 dollars). This plan would provide a disability benefit (based on the primary insurance amount) using the current law formula, but reduced to reflect the age-based reduction applicable to age 65 as the NRA rises. This would lead to a 30% reduction when fully phased-in. Without the protection of well-funded private accounts, which people with disabilities are unlikely to have, this reduction would harm beneficiaries in the disability insurance program.

Increased Risk and Capacity to Manage Accounts—The increased risk associated with retirement that depends upon private account earnings is an issue for everyone. In addition, the capacity of an individual to manage these private accounts profitably is similarly an issue for everyone, and involves many factors including education, money management skills, and risk-taking. The risks and management issues become a much more significant concern when considering people with cognitive impairments, such as mental retardation, or mental illness, when the impairment creates substantial barriers to the individual's ability to make wise and profitable decisions over a lifetime. In many cases, the person may be unable to make any financially significant decisions. Privatization removes the shared-risk protection of social insurance and places these individuals at substantial personal risk.

Again, we strongly recommend that the Subcommittee and Congress only consider legislation that maintains the basic structure of the current system based on workers' payroll taxes; preserves the social insurance disability, survivors, and retirement programs; guarantees benefits with inflation adjustments; and preserves the Social Security trust funds to meet the needs of current and future beneficiaries. Changes necessary to bring the trust funds into long-term solvency must not be so drastic as to undermine or dismantle the basic structure of the program.

To assist the Subcommittee, and, indeed all parties to the debate, we urge the Subcommittee to follow through on a suggestion made at an earlier hearing to request a beneficiary impact statement from SSA on every major proposal, or component of a proposal, under serious consideration. In a program with such impact on millions of people of all ages, it is simply not enough to address only the budgetary impact of change; the people impact must also be studied and well understood before any change is initiated. For our constituency, people with disabilities, their very lives depend on such analyses.

Again, I thank the Subcommittee for considering our viewpoints on these critical issues. People with disabilities and their families will be vitally interested in the Subcommittee's work; the CCD Task Force on Social Security pledges to work with you to ensure that disability issues remain an important consideration in reform analysis and solution development.

ON BEHALF OF:

Adapted Physical Activity Council
American Network of Community Options and Resources
Bazelon Center for Mental Health Law
Children and Adults with Attention Deficit Disorders
International Association of Psychosocial Rehabilitation Services
National Alliance for the Mentally Ill
National Association of Developmental Disabilities Councils
National Association of Protection and Advocacy Systems
National Association of State Directors of Developmental Disabilities Services
National Easter Seal Society
Paralyzed Veterans of America
Research Institute for Independent Living
The Arc of the United States
United Cerebral Palsy Associations, Inc.

STATEMENT OF RUTH HUGHES, PH.D., CHIEF EXECUTIVE OFFICER, INTERNATIONAL ASSOCIATION OF PSYCHOSOCIAL REHABILITATION SERVICES, COLUMBIA, MARYLAND

Ms. HUGHES. Chairman Shaw and Members of the Subcommittee, I appreciate the opportunity today to address the potential impact of Social Security reform on people with mental illness. My name is Ruth Hughes, and I am the chief executive officer of the International Association of Psychosocial Rehabilitation Services, an association that represents both individuals and agencies that provide treatment and rehabilitation for those with severe mental illness.

Severe mental illnesses usually strike an individual at the beginning of adulthood, between the ages of 18 and 25. A quick example to help illustrate what I would like to say later: Dave is first diagnosed with schizophrenia and hospitalized when he is 18. He spends the next 7 years of his life in and out of treatment and rehabilitation programs. At 25, he enters the work force for the first time with a part-time position, making minimum wage. With medication and with ongoing support, he is able to manage 20 hours a week, but not more. Over the next 10 years, he is in and out of the hospital and in and out of the work force. In his mid-thirties, the symptoms of his illness become more manageable, and Dave slowly works toward a full-time position. Even with a full-time job, Dave is unable to cover his medication and health expenses. With his family's financial assistance, he just manages to get by. But as Dave reaches his forties, his father passes away and his mother is no longer able to help financially. Without adequate medication, Dave experiences a serious relapse, is fired from his position, and is rehospitalized. The slow process of recovery must begin again, and Dave does not reenter the work force for many years.

This pattern, while it changes for every individual, is very typical of people with severe psychiatric disabilities. Most people with psychiatric disabilities enter the work force later; they work intermittently, as they are able to, and they make significantly less income than their peers. Salary over a lifetime is a fraction of what it might be without a mental illness. The cost of medication and treatment, even when health insurance is available, is a major and necessary living expense. The result is the vast majority of those persons with psychiatric disabilities who do work are working poor.

Congress is currently in the process of reviewing and considering a number of proposals to reform the Social Security Program. It is important that any reform proposal not risk the integrity or compromise the universality of either the Disability Insurance Program, SSDI, or the Social Security Retirement Program.

Some of the proposals to reform the retirement program have serious and unintended consequences for people with mental illness. For example, increasing the retirement age may not seem to have an impact on folks with disabilities. However, it could have a serious impact on the SSDI Program. People whose disabilities occur later in life, say at age 62, can take early retirement. But as the retirement age increases, that 62-year-old disabled worker is forced onto the disability income rolls. The DI Program is already growing at an unsustainable rate. In a few years it is expected to begin placing a strain on the overall Social Security Trust Fund. An influx of older persons could endanger the integrity of the SSDI Program, unless the ramifications are carefully considered and addressed in any reform that happens.

Another proposal would have people manage their own retirement accounts. Assuming the government requires you set aside the requisite funds, this might work for a disabled individual if you earn at or above the median national income for most of your working years, you are able to work during most of those working years, and you are a savvy investor.

But a person who works only intermittently for low wages, and often part time, is unlikely to have enough at retirement to pay for even the basic necessities of life. For some people with mental disabilities, the cognitive deficits associated with a mental illness may, in fact, interfere with the ability to make prudent financial and investment decisions.

The bottom line, Mr. Chairman and Members of the Subcommittee, is that no plan will enjoy the support of people with disabilities unless the integrity of the SSDI Program is protected and the universality and the progressivity that protects people with disabilities under the current retirement system is also present. It is imperative that each proposal be evaluated for its impact with people with disabilities and we address these potential and largely unintended consequences, or we may well destroy the fragile safety net for those with disabilities.

Thank you.

[The prepared statement follows:]

Statement of Ruth Hughes, Ph.D., Chief Executive Officer, International Association of Psychosocial Rehabilitation Services, Columbia, Maryland

Chairman Shaw and members of the subcommittee, I appreciate the opportunity to testify this afternoon on the issue of Social Security solvency and reform and, in particular, to address this issue as it could affect people with mental illness.

I am Ruth Hughes, CEO of the International Association of Psychosocial Rehabilitation Services, an association that represents individuals and agencies that provide treatment and rehabilitation, housing, case management, job training and vocational rehabilitation to people with severe mental illnesses.

When we discuss the issue of Social Security reform and people with mental illness, it is important to start at beginning. Severe mental illnesses like depression, manic-depression, and schizophrenia, usually strike an individual at the beginning of adulthood, between the ages of 18 and 25. Dave is a young man who was first diagnosed with schizophrenia and hospitalized when he was 18. His hopes of attending college are dashed, and he spends the next seven years in and out of treatment and rehabilitation programs. At 25 he enters the workforce with a part time position making minimum wage. With medication and ongoing support, he is able to manage 20 hours a week but not more. Over the next ten years he is in and out of the hospital and in and out of the workforce. In his mid thirties, the symptoms of his illness become more manageable and Dave slowly works toward a full time position. However the pay is still minimum wage; the benefits are poor, and there is no health insurance. Even with a full time job, Dave is unable to cover his medication and health expenses. With his family's assistance, he just manages to get by. As Dave reaches his forties, his father passes away and his mother is no longer able to provide the financial assistance his family provided in the past. Without adequate medication, Dave experiences a serious relapse, is fired from his position and is hospitalized. The slow process of recovery begins again, and Dave does not re-enter the workforce for another five years.

Most people with psychiatric disabilities enter the workforce later, work intermittently as they are able, and make significantly less income than their peers. Salary over a life time is a fraction of what might be anticipated without a mental illness. While the unemployment rate for all people with disabilities is a whopping 71%, for people with psychiatric disabilities the rate is 85% to 90%. The cost of medication and treatment, even when health insurance is available, is a major and necessary living expense. The result is the vast majority of those persons with psychiatric disabilities who do work are working poor.

Consequently, the current construct of the Social Security program, including both the disability program and the retirement program, is critical for people with mental illness. The Social Security Disability Insurance program is essential for people whose working career is intermittently interrupted because of disability. The universal coverage and progressive, guaranteed benefit structure of Social Security ensures that people whose lives have been impacted by severe disabilities, including mental illnesses, do not approach retirement age staring at poverty.

Congress is currently in the process of reviewing and considering a number of proposals to reform the Social Security program. While consensus around a specific plan has not been reached, it is important that any reform proposal not risk the integrity or compromise the structure of either the Disability Insurance program, SSDI, or the Social Security retirement program.

Some of the proposals could have serious consequences for people with mental illness. For example, accelerating the increase in the retirement age seems fairly non-controversial. However, it could have a severe impact on the SSDI program. People whose disabilities occur later in life, say at age 62, can take early retirement and qualify for Social Security rather than SSDI. But as the retirement age increases, that 62 year old disabled worker is forced onto the DI rolls where they will stay until they transfer to the retirement program. The DI program is already growing at an unsustainable rate. In a few years, it is expected to begin placing a strain on the overall SS Trust Fund. An influx of older disabled persons could endanger the integrity of the SSDI program unless the ramifications are carefully considered.

Another proposal would have people manage their own retirement accounts. Assuming the government requires you set aside the requisite funds, its probably not a bad idea IF you earn at or above the median national income for most of your working years and are a savvy investor. In that case a disabled individual could and probably would save enough for retirement. But a person who works only intermittently, for low wages and often part time is unlikely to have enough at retirement to pay for the basic necessities of life. For some people with mental disabilities, the cognitive deficits associated with the disability may in fact interfere with the ability to make prudent investment decisions.

I have only touched on a couple of the proposals that Congress might consider, but the bottom line, Mr. Chairman and members of the subcommittee, is that no plan will enjoy the support of people with disabilities unless the integrity of the SSDI Program is protected and the universality and progressivity that protects them under the current retirement system is present. It is imperative that each proposal be evaluated for its impact on people with disabilities and any potential unintended consequences which may destroy the fragile safety net for those with severe disabilities.

Again, Mr. Chairman, thank you for the opportunity testify this afternoon.

STATEMENT OF RICHARD V. BURKHAUSER, CHAIR, DEPARTMENT OF POLICY ANALYSIS AND MANAGEMENT, CORNELL UNIVERSITY, ITHACA, NEW YORK

Mr. BURKHAUSER. Thank you, Chairman Shaw. The following four propositions reflect my perspective on how to save Social Security, while protecting the most vulnerable members of our society.

One, every person in this room will die. This proposition requires no additional evidence. Unfortunately, it will occur even if you come from a safe district.

Two, most of us will experience the onset of a disability before we die, and many of us will do so while we are of working age. My research shows that most adults with disabilities experience their disability as adults.

Three, the most effective way to observe the importance of disability on work and economic well-being is to follow people before and after the onset of a disability. In tables 1 and 2 of the paper that I am submitting, I do this and show that, thanks to increases in the work of other family members and our Social Security safety net, the onset of a disability is not a devastating event for most people. While not perfect, on average, our system works to prevent serious economic losses, including a drop into poverty, following a disability.

Four, the social welfare networks created in western countries to offset economic effects of old age, death of a spouse, and disability are in financial trouble. Two main demographic forces are behind this problem. The first and best known is the graying of the aging baby boomers. At age 53, I am the oldest of that post-World War II generation that will increasingly start knocking at the door of the disability system over the next decade and the retirement system in the following decade.

The second is the long-run improvement in both age-specific mortality and morbidity rates and the expected improvement of those rates in the future. I show that in table 3.

In the years between 1930, when the baby boomers parents were born, and 1990, when their children were born, life expectancies at birth increased by 10 years for both men and women. Even more important, recent studies have shown that the age-specific risk of disability over the life cycle has declined.

The problem with this good news is that the primary risk that Social Security protects us against—that is, living too long after retirement; hence, running out of money to support ourselves—will be much greater for the baby boomers than it was for our parents, and even riskier for our children.

Hence, as I see it, baby boomers and their children have three choices: Save more to pay for a greater number of years in retirement, either through higher Social Security taxes or privately; work to an older age than did their parents, or agree to die at the same age as their parents and, even better, their grandparents.

Let me suggest that not only is option 2 viable for most baby boomers, but it can be accomplished without dramatically increasing the risk of poverty for most people. In my work and in a new CBO study, we confirm that the vast majority of workers who currently take early Social Security benefits are in good health, could continue to work, and have other sources of income sufficient to keep them out poverty, even if they had not received Social Security.

Table 4 shows, for instance, that only 7 percent of men who took early retirement benefits were both in poor health and did not have an employer pension. The number is a little higher for blacks. It is 11 percent. But like whites the vast majority of blacks are fully capable of working or have private pension.

However, it is imperative that social policy encourage work without abandoning the minority of older people with poor health and little wealth who cannot continue to work. Can this be done?

The answer is demography is not destiny. To see the power that public policy plays in the way people exit the labor force, it is useful to compare the United States and the Netherlands. Both countries have seen dramatic improvements in the wealth and health of their populations. However, the Dutch have among the highest taxes on work in Western Europe, and they fund an elaborate and highly protective social insurance system that provides strong incentives to workers to leave the labor force through the disability rolls. Appendix tables 1 and 2 of my paper show the results of such policies. The Dutch have dramatically higher ratios of disability transfer recipients per 1,000 workers at all ages, and Dutch workers leave the labor force far earlier than we do in this country. These outcomes are the result of policy decisions, not differences in the underlying health of the two countries.

So what policies should we pursue?

(a) Better integrate people with disabilities in the work force. This is the goal of the Americans with Disabilities Act of 1990. In addition to enforcing this law, we need prowork policies to do something for the Daves of the world that we just heard Ruth Hughes talk about to keep them in the work force. We should provide tax subsidies for employers who experience real costs in accommodating workers with disabilities; as well as tax subsidies for relatively low productivity workers or part-time workers via disability tax credit.

In my view President Clinton's greatest achievement, which he achieved with bipartisan support, was the increase in the earned income tax credit. But his advisors told him: People with disabilities aren't expected to work. So that tax credit doesn't do much for folks with disabilities. People with disabilities can work and this credit should be targeted toward them. Tax subsidies for health care insurance, should also be considered.

All of these credits can be paid for if we agree that healthy workers should work to age 65. However, not everyone can work. We need to adjust other elements of the social safety net for those who can't work.

Two changes that should be considered if we raise the earliest age for Social Security retirement benefits to 65 are: lowering the age of Old Age Supplemental Security Income benefits from 65 to 62 and maintaining age as a vocational factor in determining disability eligibility. These two changes will provide a safety net for those who cannot work to age 65 in a far better-targeted manner than our current system, and for far less cost both to the Federal budget and, more importantly, to the productivity of our country.

Thank you, and I look forward to your questions.

[The prepared statement follows:]

Statement of Richard V. Burkhauser, Chair, Department of Policy Analysis and Management, Cornell University, Ithaca, New York

The following propositions based on my past research reflect my perspective on how to save Social Security while protecting the most vulnerable member of our society.

1. Every person in this room will die.

This proposition requires no additional evidence, unfortunately and will occur even if you come from a safe district.

2. Most of us will experience the onset of a disability before we die, and many of us will do so while we are of working age.

Based on data from the Health and Retirement Study, a major new longitudinal data study funded by a government consortium lead by the National Institute on Aging (NIA), Burkhauser and Daly (1996) show that most people with disabilities aged 51 to 61 in 1992 experienced the onset of their disability as an adult.

3. The most effective way to observe the importance of disability on wealth and economic well-being and the ability of government policies to ameliorate a disability's influence is to track the labor earnings and economic well-being of people with disabilities before and after onset of a disability.

Burkhauser and Daly (1996) do so and find that, thanks to increases in the work of other family members and Social Security Disability Insurance (SSDI) and Supplemental Security Income-disability (SSI) safety net benefits, the onset of a disability is not a devastating economic event for most people. (See Tables 1 and 2.) For men, the median change in before government income is a drop of 10 percent. When government transfers are taken into consideration the news is even better. After one year the median fall for men is less than 3 percent.

While not perfect, on average our disability system works to prevent serious economic losses including a drop into poverty for the households of adults who experience the onset of a disability. Hence, if forced to label persons with disabilities as either heroes who overcame their disabilities or as victims who were overwhelmed by them and suffered dramatic economic losses, the stereotype I would choose is hero.

4. The sophisticated social insurance and welfare network created in Western Industrialized Countries to offset the economic effects of old age, death of a spouse, and disability are in financial trouble.

Two major demographic forces require changes in the across generation social contract that establishes the size and scope of social security protection in most Western Industrialized Countries. The first and best known is the graying of the babyboom generation. At age 52, I am the oldest of that post-World War II generation that will increasingly make use of the SSDI and SSI disability rolls over the next decade and of the social security retirement system (OASI) in the following decade.

The second is the long-term improvement in both age specific mortality and morbidity rates, and the expected improvement in those rates in the future (See Table 3). In the years between 1930, when the babyboomers' parents were born, and 1990, when their children were born, life expectancy at birth increased from age 66 to 76 for men and from age 73 to 83 for women. Even more important, recent NIA studies by Ken Manton and others have shown that the age specific risk of a disability over the life-cycle has also declined.

The problem that this good news brings to our social security retirement system is that the primary risk that social security old-age insurance protect us against—living too long after retirement and hence running out of money to support ourselves—will be much greater for babyboomers then it was for their parents and even riskier for their children. Hence, babyboomers and their children have three choices:

1. Save more to pay for a greater number of years in retirement either through higher Social Security taxes or privately.
2. Work to an older age then did their parents.
3. Agree to die at the same age as did their parents or even better their grandparents.

Let me suggest that not only is option two viable for most babyboomers but it can be accomplish without dramatically increasing the risk of poverty for most people without disabilities. Burkhauser, Couch and Phillips (1996) show and a new Congressional Budget Office study (Smith, 1999) confirms, that the vast majority of workers who took early Social Security benefits in the early 1990s were in good health, could have continued to work, and had other sources of income sufficient to keep them out of poverty, even if they had not received Social Security. Table 4 using data from the HRS shows for instance, that only 7 (11) percent of white men who took early OASI benefits were both in poor health and did not have an employer pension.

Major improvements in the health and wealth of older workers make it clear that the vast majority of such workers could cope with an increase to age 65 as the earliest age of Social Security retirement. (This was the earliest Social Security retirement age for men prior to 1961.) However, it is imperative that social policy encourage increased work without abandoning the minority of the older working age population with poor health and little wealth who can not continue working.

Table 5, taken from Burkhauser and Weathers (1998) uses HRS data to show the wealth distribution of men and women aged 51 to 61 in 1992. In each of the bottom four deciles of the wealth distribution, expected OASI benefits make up the majority of their wealth portfolio. Hence, those proposing changes in the Social Security System must recognize its importance in the lives of older Americans.

DOES POLICY MATTER

Demography is not destiny. Public policies can be enacted to adjust our social welfare system to the problems associated with the longer and healthier lives succeeding generations of Americans will lead. To see the power that public policies play in the way people exit the labor force, it is useful to compare labor force behavior in the United States and The Netherlands. Both of these Western Industrialized Countries have seen dramatic improvement in the wealth and health of their populations. However, the Dutch have among the highest taxes on work in Western Europe and fund an elaborate and highly protective social insurance system that provides strong incentives for workers to leave the labor force through the disabilities rolls. Appendix Tables 1 and 2 show the results of such policies. The Dutch have dramatically higher ratios of disability transfer recipients per worker than does the United States at all ages and leave the labor force far earlier than we do in this country. These outcomes are the result of policy decisions not in differences in the underlying health of the two countries. Public policy can either focus on better integrating people with disabilities into the labor force or on encouraging them to leave the labor force.

Preserving the social security safety net for people with disabilities while saving the Social Security System from demographic forces

A. Better integrate people with disabilities into the workforce

Social Security is funded by a tax on work and it provides benefits based on past labor earnings. Hence for the health of the system as well as to best protect people with disabilities when they must leave the labor force, people with disabilities should work as long as other Americans. It is therefore in their interest and the interest of society that the market place be accessible. This is the goal of The Americans with Disabilities Act of 1990 (ADA). In addition to enforcing this law, pro-work policies for people with disabilities should include:

- Tax subsidies for employers who accommodate workers with disabilities. This carrot of subsidy to offset accommodation cost along with the regulatory stick of the ADA would encourage employers to keep people with disabilities on the job. Burkhauser, Butler, Kim and Weathers (forthcoming) provide evidence that accommodation substantially extends work and reduces dependence on SSDI.
- Tax subsidies for relatively low-productivity workers via a Disabled Worker Tax Credit. This pro-work subsidy could, for instance, help to transition the one million children now on the SSI-children transfer rolls into the labor force rather than onto the permanent SSI rolls. (See Burkhauser, Glenn and Wittenburg, 1997 for fuller discussion)
- Tax subsidies for health care insurance. Medicare buy-ins for people with disabilities would offset the single most difficult obstacle for people with disability—who have greater risks of future health care cost—to being offered and accepting market work. For workers with disabilities who are fully integrated into the work force, no specific changes in Social Security policy are necessary. For those who are not we must turn to transfer policies.

B. Adjust other elements of the social safety net for those who can't work

Two changes in our Social Security System that should be consider if we raise the earliest age of OASI benefits to age 65 are:

- Lower the age of Supplemental Security Income—Old Age From 65 to 62. Supplemental Security Income (SSI) was established in 1972 to provide a social safety net under the aged and disabled who did not have sufficient OASDI benefits to reach a minimum income floor. Eligibility based on age should be lowered to age 62 as the earliest age for Social Security benefits is raised to 65. This would offer a guaranteed minimum income to the small minority of older workers who could not work to age 65 and who do not have the financial means to support themselves.
- Maintain Age as a vocational factor in determining SSDI and SSI disability eligibility. SSDI and SSI-disability already provide benefits to workers under age 65 who are not capable of substantial gainful activity. Age is and should be a factor in determining disability status from those unable to work. Such a criteria ensures those older persons of working age who are covered by SSDI that these benefits are available if they are unable to work.

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Table 1. Economic Changes Following the Onset of a Disability among Working Age Men and Women in the United States, 1970–1989 [1] [2]

Time Point	Men				Women			
	Percent Working Positive Hours	Median Labor Earnings [3]	Equivalent Median 1991 Dollars [4]		Percent Working Positive Hours	Median Labor Earnings [3]	Equivalent Median 1991 Dollars [4]	
			Before Government Income	After Government Income			Before Government Income	After Government Income
Two Years Prior	90.4	21,215	17,347	16,224	67.3	5,063	18,247	16,842
One Year Prior	90.8	21,543	18,381	16,812	68.0	6,582	19,921	17,370
Year of Disability Event	87.2	18,760	16,434	16,160	70.0	5,995	19,827	17,923
One Year After	72.3	13,220	14,567	15,739	63.6	3,277	18,446	17,859
Two Years After	68.2	11,798	13,930	15,406	57.6	1,699	20,251	18,537
Median Percent Changes From:								
One Year Prior to One Year After Disability	na	–24.0	–9.7	–2.6	na	–41.0	1.7	5.0
One Year Prior to Two Years After	na	–31.0	–12.1	–3.7	na	–61.7	5.5	7.6

[1] The sample is based upon data from the 1970 to 1989 waves of the PSID. The sample includes household heads and spouses who report two consecutive periods of no disability followed by two consecutive periods of disability, who were between the ages of 25 and 61 at onset. A period of disability is one in which the respondent reports that a physical or nervous condition limits the type of work or the amount of work that he/she can do.

[2] Sample size for men in the first four periods is 725. It is 677 in the fifth period (two years after). Sample size for women in the first four periods is 303. It is 236 in the fifth period (two years after). The sample size is smaller for women because the PSID did not ask about spouses' disability status until 1981.

[3] Median labor earnings includes zero earnings. Earnings are in 1991 dollars.

[4] Before and After Government incomes are adjusted for household size using the equivalence scale implied by the United States poverty line. Income to Needs ratios can be computed by dividing equivalent median income by the 1991 one person poverty threshold of $6,932.

Source: Burkhauser and Daly (1996), Table 4, p. 71.

Table 2

CUMULATIVE OCCURRENCE OF ECONOMIC CONSEQUENCES FOLLOWING THE ONSET OF A DISABILITY[a]

Years Since Onset of a Disability	Stop Working[b]		Return to Work[b]		Fall into Poverty[c]		Economic Recovery[d]		Recovery from Disability[e]		Receive Transfers[f]	
	25-50	51-61	25-50	51-61	25-50	51-61	25-50	51-61	25-50	51-61	25-50	51-61
1	0.15 (0.013)	0.24 (0.023)	0.28 (0.025)	0.14 (0.021)	0.08 (0.019)	0.08 (0.012)	0.46 (0.016)	0.46 (0.022)	na	na	0.14 (0.016)	0.19 (0.021)
2	0.26 (0.016)	0.35 (0.026)	0.46 (0.029)	0.19 (0.025)	0.13 (0.012)	0.13 (0.016)	0.63 (0.016)	0.57 (0.022)	0.02 (0.005)	0.01 (0.003)	0.22 (0.019)	0.29 (0.024)
3	0.32 (0.017)	0.42 (0.027)	0.52 (0.030)	0.22 (0.027)	0.17 (0.013)	0.17 (0.018)	0.72 (0.016)	0.64 (0.023)	0.04 (0.007)	0.02 (0.006)	0.30 (0.022)	0.40 (0.027)
4	0.38 (0.019)	0.49 (0.028)	0.58 (0.031)	0.24 (0.028)	0.20 (0.015)	0.20 (0.019)	0.77 (0.016)	0.69 (0.023)	0.13 (0.013)	0.07 (0.012)	0.36 (0.024)	0.53 (0.029)
5	0.44 (0.019)	0.53 (0.028)	0.61 (0.032)	0.28 (0.031)	0.22 (0.016)	0.22 (0.020)	0.84 (0.016)	0.75 (0.024)	0.13 (0.013)	0.07 (0.013)	0.45 (0.027)	0.70 (0.029)
Median Years to Outcome	5+	5	3	5+	5+	5+	2	2	5+	5+	5+	4

[a]Sample is based upon data from the 1970 through 1989 waves of the PSID. Sample includes household heads and spouses who report two consecutive periods of no disability followed by two consecutive periods of disability and who were between the ages of 25 and 61 at onset. A period of disability is one in which the respondent reports that a physical or nervous condition limits the type of work or the amount of work that he/she can do.

[b]Excludes individuals who were not working one year before onset.

[c]Poverty calculated using the United States poverty thresholds and the official income definition.

[d]Includes individuals who experience no loss of income at the onset of a disability.

[e]Recovery occurs when a respondent reports that he/she does not have a physical or nervous condition that limits work.

[f]Excludes individuals who receive transfers in the year before onset. Transfers include: Social Security Disability Insurance; Supplemental Security Income; Veterans Disability Benefits; Workers Compensation; Social Security Retirement Insurance.

Note: Values represent the probability that an outcome has occurred by time t. Values in parentheses are standard errors assuming simple random sampling.

Source: Burkhauser and Daley (1996), Table 5, p. 73.

Table 3. Life Expectancy for Babyboomers, Their Parents, and Their Children

A Person Born in:	Will Reach Age 65 in:	Life Expectancy in Years			
		Males		Females	
		At Birth	At Age 65	At Birth	At Age 65
1930	1995	65.7	15.6	73.4	19.8
1955	2020	71.9	16.8	79.5	21.0
1990	2055	76.4	18.2	83.3	22.7

Source: Office of the Social Security Actuary, 1992.

Table 4. Employer Pension Eligibility, Health, and Household Net Assets of Men and Women Who Take or Postpone Taking Social Security Benefits at Age 62 in 1993 or 1994

Race	Gender	Employer Pension Eligibility [1]	Poor Health 1994 [2]	Takers: Sample Share [obs]	Takers: Median Household Net Assets 1992	Takers: Median Household Net Assets 1994	Postponers: Sample Share [obs]	Postponers: Median Household Net Assets 1992	Postponers: Median Household Net Assets 1994
Black	Men	yes	yes	0.18*	—	—	0.07*	—	
		yes	no	0.43	$90,000	$102,500	0.41	$83,250	$78,000
		no	yes	0.11*	—	—	0.21	$2,500	$105
		no	no	0.29*	—	—	0.31	$32,900	$48,000
White	Men	yes	yes	0.15	$193,000	$103,750	0.11	$123,000	$105,000
		yes	no	0.51	$180,550	$202,700	0.50	$180,250	$218,465
		no	yes	0.07*	—	—	0.09	$144,350	$161,000
		no	no	0.28	$207,480	$218,500	0.29	$203,000	$194,500
Black	Women	yes	yes	0.03*	—	—	0.07*	—	
		yes	no	0.35	$82,750	$126,750	0.19	$85,500	$126,000
		no	yes	0.27	$7,200	$33,000	0.29	$3,100	$5,750
		no	no	0.35	$56,000	$46,900	0.45	$36,750	$44,750
White	Women	yes	yes	0.03*	—	—	0.07	$140,100	$216,300
		yes	no	0.20	$153,000	$198,000	0.36	$190,000	$225,000
		no	yes	0.26	$199,250	$154,500	0.16	$92,468	$77,500
		no	no	0.51	$187,000	$191,500	0.40	$166,150	$192,750

[1] Respondent reports either receiving private pension income in 1992 or that they expect to receive private pension income in the future.
[2] Respondent reports being in fair or poor health in 1994.
*Less than ten observations. Medians are not reported in these cases.
Source: Health and Retirement Study, Gamma version of Wave 1 (1992) and Beta version of Wave 2 (1994). For more details see Phillips (1997).

Table 5. Distribution of Total Net Household Wealth and its Components by Person-Based Wealth Deciles in 1992 for Persons Aged 51 through 61

(in 1992 dollars)

Wealth Decile	Mean Total Net Wealth	Mean Net Financial Wealth	Mean Net Housing Wealth	Mean Net Social Security Wealth	Mean Net Pension Wealth
Bottom	34,084	2,801	−5,015	35,570	1,115
	(0.86)[1]	(0.20)	(−0.10)	(3.64)	(0.16)
2	77,890	5,888	8,781	58,955	4,522
	(1.97)	(0.48)	(1.99)	(6.89)	(.74)
3	115,625	14,588	17,707	72,604	10,859
	(2.92)	(1.22)	(4.06)	(8.61)	(1.79)
4	155,189	22,496	28,285	84,366	20,201
	(1.92)	(1.84)	(6.37)	(9.82)	(3.24)
5	195,646	33,913	35,774	91,353	34,299
	(4.94)	(2.87)	(8.32)	(10.99)	(5.74)
6	243,018	52,211	44,280	95,240	51,262
	(6.13)	(4.21)	(9.82)	(10.92)	(8.17)
7	301,493	79,162	54,482	100,275	67,727
	(7.61)	(6.40)	(12.12)	(11.53)	(10.83)
8	380,665	109,862	64,561	106,528	99,616
	(9.63)	(8.92)	(14.41)	(12.29)	(15.98)
9	518,327	186,173	76,772	109,304	146,311
	(13.09)	(14.92)	(16.92)	(12.45)	(23.18)
Top	1,210,203	750,315	124,991	115,263	194,356
	(30.57)	(58.93)	(26.99)	(12.86)	(30.17)
All	319,395	124,115	45,146	87,338	62,795
	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)
Share of Total Wealth	100.00	38.86	14.13	27.34	19.66
GINI[2]	0.49	0.75	0.45	0.10	0.59
90–10 Ratio ..	10.93	4058.5	—	3.46	—

Source: Burkhauser and Weather (1998) based on data from the Health and Retirement Study Weave 1 Final Release.

Notes: HRS sample weights were used to make the sample representative of men and women aged 51 through 61 in 1992. Equivalence scale is (e) = 0.5.

[1] Column shares are in parentheses.

[2] All negative wealth values are assigned a zero value in the calculations

Appendix Table 1. Disability Transfer Recipients per Thousand EmployedWorkers by Age in the United States and The Netherlands

Population	1970	1975	1980	1985	1990	1994
Aged 15 to 64						
United States	27	42	41	41	43	62
The Netherlands	55	84	138	142	152	151
Aged 15 to 44						
United States	11	17	16	20	23	38
The Netherlands	17	32	57	58	62	66
Aged 45 to 59						
United States	33	68	83	71	72	96
The Netherlands	113	179	294	305	339	289
Aged 60 to 64						
United States	154	265	285	254	250	294
The Netherlands	299	437	1,033	1,283	1,987	1,911

Source: Aarts, Leo J.M., Richard V. Burkhauser, and Philip P. De Jong (eds.). Curing the Dutch Disease: An International Perspective on Disability Policy Reform. Aldershot, Great Britain: Avebury (1996).

Appendix Table 2. Prevalence of Work and Transfer Benefits for Men by Age in The Netherlands and the United States

Age	Working[1]	Not Working		
		Disability Transfers[2]	Employer Pension[3]	Other[4]
United States				
51	82.6	4.1	0.9	12.4
52	84.9	3.0	2.4	9.9
53	82.8	3.5	0.5	13.2
54	84.6	2.9	2.7	9.8
55	78.5	4.5	1.8	15.3
56	76.9	5.0	6.3	11.8
57	80.3	4.6	7.0	8.0
58	71.5	7.5	9.2	12.0
59	68.9	6.5	9.3	15.3
60	67.9	6.1	12.6	13.3
61	65.9	5.6	16.0	12.5
The Netherlands				
51	83.3	13.7	0.0	3.0
52	87.5	8.1	1.9	2.5
53	81.9	14.1	1.7	2.3
54	74.6	17.2	1.9	6.2
55	72.2	16.7	3.5	7.5
56	59.0	23.9	10.2	6.8
57	58.7	17.4	15.6	8.3
58	49.0	25.0	19.0	7.0
59	44.1	23.2	27.5	5.2
60	20.9	33.3	42.3	3.5
61	16.8	26.9	50.5	5.8

[1] Those who are working at the time of the interview—1993 in The Netherlands and 1992 in the United States.
[2] Those who are not working and are receiving disability transfers at the time of the interview.
[3] Those who are not working or receiving disability transfers but who are receiving private pension benefits at the time of interview.
[4] Those who are not working and receiving neither disability transfers nor private pension benefits at the time of interview.
Source: Burkhauser, Richard V., Debra Dwyer, Maarten Lindeboom, Jules Theeuwes, and Isolde Woittiez (forthcoming). Data from The Netherlands are weighted values of the 1993 Wave 1 CERRA Retirement Panel Study. Data from the United States are weighted values of the 1992 Wave 1 Gamma Release of the Health and Retirement Study.

—

Chairman SHAW. Thank you. Mr. Hulshof.

Mr. HULSHOF. Thanks, Mr. Chairman.

Hopefully, as an appropriate segue, Mr. Burkhauser, to your last comments, I hope each of you on the panel recognizes the work that this Subcommittee and its former Chairman has done in your area of expertise. I think there are Members on the Subcommittee that do want to try to encourage and remove as many barriers that are in the way for the disabled community to return. I see everybody is nodding their heads.

I know that on the Senate side, Senators Kennedy and Jeffords and others have talked about that. Mr. Chairman, my staff tells me I would be remiss if I didn't at least mention that there are some of us—myself, Congressman Ramstad, Congressman Lazio, and others—that hope that we can continue that work, but that is not the subject of this hearing. So I do want to put that quick, 30-second commercial plug.

Thank you, Mr. Chairman.

The Social Security Trust Funds, actually, what we have been talking about is combining both the old age survivor insurance and the disability insurance. Actually, as I understand it—and please correct me if I am wrong—the disability insurance, the DI Trust Fund is really in more trouble regarding solvency than the OASI fund. The number that I have seen, rather than 2032, is that the DI Trust Fund will be completely insolvent around 2019. Yet, we have not been talking about that, or at least witnesses and advocates, that has not been part of the equation.

Especially Dr. Hughes, you brightened when I mentioned that this is a problem. I throw this out to any of you on the panel. Should DI reforms be considered, as we undertake this difficult task? Dr. Hughes, I will pick on you first.

Ms. HUGHES. Well, I think that there are things happening which we need to pay attention to. We have more people with disabilities in this country because people are living longer. Things that people used to die from, now they may have a chronic illness and have a disability that, then, they can live with, and often continue to work with, but not always.

So our risk as a country is greater than it has been in the past, when it comes to disability. That is a fact that I think is very important to pay attention to.

The enrollment in the SSDI Program, as I understand it, is increasing. We are facing serious financial problems with that portion of the program.

All of us at this table have been working to help people change policies, so more people with disabilities can go to work. An irony of that is that, for psychiatric disabilities, people who are currently on SSI would be moving to the SSDI rolls, as they work longer, and therefore, become eligible for that. That is not going to go away; that is a fact of life.

So I think it is important to look at how the disability program relates to and fits with the retirement program. The structure of the program, though, is one, I think, that I would—and many of us—would be very reluctant to see changed. It is a financial issue rather than a structural issue.

Mr. HULSHOF. OK. Anybody else want to weigh in?

Ms. OWENS. I would just like to say that the line between the DI Trust Fund and the OASI Trust Fund has always been kind of blurry. Having been in the disability program, there have been times in the past years where the Disability Program has, in fact, had to borrow from the OASI Trust Fund, and there has, in fact, been a time, as Marty tells me, that the OASI Trust Fund borrowed, in effect, from the DI Trust Fund.

So I think, to me, the issue is not so much of the Trust Funds. I think it does go back to your point, what you are trying to do to fix the Disability Program. The issue is using some of the remedies that you are suggesting of getting people back to work and looking at the program, recognizing that one size doesn't fit all.

So I would encourage you to think about what you are doing in relationship to the financing issue.

Mr. HULSHOF. Ms. Ford, either one, my time is running short.

Ms. FORD. Well, I would agree with what they have both said, and just reiterate also that people with disabilities, particularly adult disabled children, can move back and forth between the DI and the OAS Trust Funds, and, in fact, SSI, and it is very difficult to try to separate them out. They really do work better together.

Mr. HULSHOF. I am sorry, Mr. Burkhauser, my time is almost up. Let me just conclude with this general statement. Ms. Ford mentions it, I just noted in her testimony, and perhaps others of you have done the same. Ms. Ford, you say in your statement, “We believe Congress should only consider legislation that maintains the basic structure of the current system based on workers’ payroll taxes.” I think that is where we started this whole debate from this Congress. Yet, now that we have heard from other expert witnesses that, as, for instance, yesterday in the Finance Committee in the Senate, that maybe that is not possible, especially under the marker that the President has put out there.

So I recognize the gentleman from Michigan, who is not here, who questioned maybe the aggressive nature of the questions of the last panel. Yet, the point is, as we learn more information, I think that we should challenge to some degree, especially based on some of the experts who are telling us that I think those are legitimate lines of questions, whether or not we agree with a proposal.

But I really appreciate you all being here today, and especially on the other issue, that we will have a chance to work on that.

Thanks, Mr. Chairman.

Chairman SHAW. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman.

Ms. Ford, you were saying, at least in your written testimony, that the Social Security insurance benefits are equivalent to $300,000 of a life insurance policy and $200,000 in terms of a disability insurance policy. Where did you get those statistics, and how was that formula acquired?

Ms. FORD. That statement comes from the Social Security Administration in terms of the general value of, for instance, of a young worker becoming disabled and the value of benefits to that worker and family, or to the family of a deceased worker.

Mr. MATSUI. Because that is the number I have seen, too, but I haven’t verified it. You, obviously, have verified it at the Social Security Administration itself.

The amount of Social Security benefits that are currently, and will continue to be, paid out, about a third of it is in the area of survivors and disability benefits. Obviously, that is a substantial sum.

The different plans that you have seen, the Feldstein plan, and I don’t even know if you are familiar with the Feldstein plan, but do those plans give you any concern in terms of cutting back on these benefit levels, given some of the implications on tax policy and deficits in the years ahead?

Ms. FORD. Well, that does cause us concern, and it is an issue in terms of what happens with the rest of the Federal budget. Even if the Social Security Trust Funds are untouched, we have to analyze critically what is going to happen to the rest of the surpluses, if there are surpluses, and the rest of the budget, and the other needs that must be met. So those are issues for us, too, yes.

Mr. MATSUI. Perhaps, Dr. Hughes, you could comment on that as well, because you represent——

Ms. HUGHES. Actually, I am not familiar with those plans, but I would be glad to take a look and get back to you and let you know if there are some concerns we have.

Mr. MATSUI. I appreciate that.

Dr. Burkhauser, in some of your studies—now you indicated that you can increase the age of retirement——

Mr. BURKHAUSER. Early retirement age?

Mr. MATSUI. I'm sorry?

Mr. BURKHAUSER. Early retirement age?

Mr. MATSUI. Early retirement. I am sorry. Will you explain that, again, to me, what you are suggesting?

Mr. BURKHAUSER. What I am suggesting is that, as we increase the normal retirement age, from 65 to 67 or 68, we ought to, in parallel, increase the early retirement age, so that the earliest age of retirement should rise to 64 or 65.

I have used the health and retirement study to look at who, in fact, is taking early benefits right now. The surprising finding is that the vast majority are healthy, could work, or they have a private pension. That study, which was highly controversial 2 years ago, has just been verified by a CBO study using a different data set.

I find that approximately 7 percent of men who take early Social Security benefits are at risk. They are in poor health and they are not eligible for a private pension. These are the folks we need to help by moving the SSI old age down from 65 to 62. And by recognizing that some of those folks are going to come onto the DI rolls. That is a reality.

But if we could increase the labor force participation rate of 62-year-olds to that of 61-year-olds, we would dramatically increase productivity and tax revenues. This would go a long way toward doing the real things that are necessary to fund the Social Security system—either increased work or increased savings.

Mr. MATSUI. I want to thank all four of you for your testimony today. We appreciate it.

I yield back.

Chairman SHAW. Mr. Collins.

Mr. COLLINS. Dr. Burkhauser, you had an interesting thought there on the tax incentives to encourage people to hire disabled back to work. What type of incentive are you referring to?

Mr. BURKHAUSER. Well, I had two ideas. One comes from the National Academy of Social Insurance's proposal, I think to the Ways and Means Committee, 2 years ago, when you asked us to suggest ways to get folks with disabilities into the work force. Pat Owens and I were both on that NASI task force.

One is to expand the earned income tax credit, by providing a disabled worker's tax credit for folks aged 18 to 25 with disabilities who work. Such a credit would encourage the million kids now on the SSI-Kids disability rolls to transition to work rather than go on to the permanent SSI rolls.

With regard to employers, accommodations cost money. It is reasonable if we, as a society, think it is appropriate for folks with disabilities to be in the work force, that we subsidize firms who have to bear additional costs to provide accommodations. I am in favor of carrots. I think they work better than sticks in terms of getting firms to act in the appropriate way.

Mr. COLLINS. What about in the area of health care? An employer oftentimes is very reluctant to hire someone who is considered disabled, because, once they come to work for them, then they have to pick them up under their group insurance. What kind of ideas do you have in the area of health insurance? Any of you? Yes, Dr. Hughes.

Ms. HUGHES. For many people with disabilities, but particularly for people with psychiatric disabilities, no health care means you are very, very ill. Without the medication and treatment you need, you will end up in a hospital for long, long periods of time. A person with a psychiatric disability must have health care to work.

The unemployment rate for people with psychiatric disabilities is 85 to 90 percent for severe disabilities. It is incredibly high. The No. 1 barrier is the loss of health care coverage. Income is something people are willing to take a risk with, but not the loss of health care coverage. If they can't get that medication and that treatment, then they are not even going to consider trying to go to work.

They also say that, in the hundreds of programs I have visited and talked with people with severe mental illness, the No. 1 thing they want to do is to go to work. They want the opportunity to do that.

Mr. COLLINS. How would you suggest covering them with health care insurance? As long as they are disabled, they are under Medicare.

Ms. HUGHES. With the SSDI Program, I think if we could change the work incentives to be more similar to those that are currently in the SSI, and that is certainly one of the things under some consideration now, being able to stay on Medicare or Medicaid, depending on which is applicable, makes an enormous difference when that person goes to work, if there is not other health insurance available for them.

Mr. COLLINS. Anyone else?

Ms. OWENS. I was just going to echo that, that the bills that Mr. Hulshof was talking about, the Kennedy-Jeffords bill, does have a provision for continuing Medicare in some cases. I think that is an important idea to consider.

Mr. COLLINS. That is all. Thank you.

Chairman SHAW. Mr. Doggett.

Mr. DOGGETT. Just continuing that same line of questioning, do I understand, Ms. Owens, that you feel that a significant number of individuals with disabilities are being discouraged from returning to the work force because they lack the ability to maintain their Medicare or Medicaid health insurance benefits?

Ms. OWENS. Yes, I do, and I don't have the actual studies that have been done, but there are studies of persons on disability who say that.

Mr. DOGGETT. Is it your belief that the bipartisan proposal that Senator Jeffords is offering in that regard is a constructive way of resolving that problem?

Ms. OWENS. Yes, it is.

Mr. DOGGETT. Is that view shared by each of our panelists?

Ms. FORD. Yes, it is shared by the Consortium for Citizens with Disabilities Task Force on Social Security.

Ms. HUGHES. Yes. We have been very involved for several years with working on that bill, and it would be an incredible boon to people with psychiatric disabilities.

Mr. BURKHAUSER. I think something needs to be done in this regard. I am not sure whether or not Kennedy-Jeffords is the way to do it.

For instance, one thing that might be done with regard to Medicare that would be very encouraging to employers to hire older workers, plus some people with disabilities, is if we went back to the old system, when Medicare was the first payor of health care, and the private sector's insurance policy was the second. I think that would lead to an increase in the demand for older workers in firms that provide health care to their employees.

We should also extend Medicare coverage for folks with disabilities who leave the DI rolls by allowing them to buy in. But the key point is to not have folks with disabilities come onto the rolls in the first place. Only about 1 percent of folks who are on the DI rolls return to work. If we quadrupled that, which would be a tremendous achievement, that is 4 percent. The real action is in keeping folks with disabilities on the job and not into the rolls in the first place.

Mr. DOGGETT. I appreciate your responses.

Ms. Ford, I suppose that it was somewhat reassuring to hear the Heritage Foundation at least support preserving the existing disability insurance benefits, but I wonder, since you were here during my colloquy with their representative and during his testimony, if you have any reaction on behalf of your Consortium for groups representing individuals with disabilities concerning the idea of spinning off the disability system and combining that with some fend-for-yourself retirement system?

Ms. FORD. Thank you. We do have some concerns about that. I mean, it is heartening to hear that there is no intention of affecting the disability program, but, as I point out in our longer testimony, in fact, all or many of the components of plans to make changes in the system will actually affect disability, regardless of whether they originally intend to or not. There are a lot of issues interwoven throughout—issues of an individual who is disabled being unable to contribute to an account during their disabled nonworking years, questions of whether they would even have access to that account during those years. Upon reaching normal retirement age, would there be an account of any value to help them?

Those are some very serious questions to ask about those kinds of proposals, and then there are lots of other issues, as I mentioned, dealing with adult disabled children who depend on their parents' work history and issues of annuities, and whether or not private accounts would be required to provide for those adult children who may live decades beyond their parents, and whether or not there is any kind of provision to deal with people with disabilities throughout the programs, and not just in the DI Program.

So we have very serious concerns, and that is why we have addressed it in the context of components to look at, because I don't think we are just going to see one proposal or another proposal passed into law. I think that we are going to see components addressed, and we want to try to look at each one of those and what the potential impact might be.

Mr. DOGGETT. What are your concerns about the impact on the adult children who might have a disability of workers in the work force?

Ms. FORD. The adult children with disabilities?

Mr. DOGGETT. With disabilities.

Ms. FORD. Of workers in the work force. Social Security uses the term disabled adult child. Their benefits are based on the parents' work history. Essentially, the parent, through his/her working years and paying payroll taxes, has earned insurance coverage for their adult disabled child. It is a very important aspect of our system. The gaps, if that were lost, would not be filled in easily, if at all, by private insurance, and that is part of why we raise very serious questions about the ability to split these programs apart and do one thing in the retirement area and something else in disability, because they are so interwoven. The insurance benefits that are earned are very interwoven.

Mr. DOGGETT. Thank you very much.

Ms. FORD. Thank you.

Mr. DOGGETT. Thank you, Mr. Chairman.

Chairman SHAW. Thank you, and we thank all of you for being here. We have a lot of repair work to do; there is no question. The Congress has too long ignored so many of these problems, and the longer we wait, the more difficult it is going to be to solve them. So, hopefully, we can rise up to the occasion in a bipartisan way and solve many of these problems.

I want to thank you for highlighting the disability portion of this, because the crisis is even greater in this area than it is in the more visible area, being the Social Security Retirement Fund.

Thank you very much.

We are now adjourned.

[Whereupon, at 4:45 p.m., the hearing was adjourned.]

[A submission for the record follows:]

Statement of Kristen Cox, Assistant Director, Governmental Affairs, National Federation of the Blind, Baltimore, Maryland

As Congress discusses both the financing and restructuring of the Social Security system, I appreciate the opportunity to present the views of the National Federation of the Blind (NFB) regarding Social Security earnings limit issues. There are over fifty thousand blind people who are members of the National Federation of the Blind. We have a local chapter of the Federation in almost every sizable population area in this country and a state affiliate in all states, Puerto Rico, and the District of Columbia. In short, NFB is organized and active in all parts of the United States.

By virtue of its size and scope NFB represents and speaks for the blind as a collective body. We speak for older blind persons and younger blind persons as well. The positions we express in hearings such as these are the result of the democratic process of debate and decision-making among people who are blind in the United States. The supreme authority of the Federation is its National Convention, which occurs annually. During the convention we openly debate (and approve or disapprove) a number of policy resolutions. In this manner the Federation is truly the blind speaking for themselves. It is not simply an organization speaking for the blind. All of our elected officers and the vast majority of our members are blind. For these reasons the NFB is widely known as the voice of the nation's blind.

ANNOUNCED PLANS TO RESTRUCTURE THE SOCIAL SECURITY SYSTEM

Blind people have a special concern in relationship to this subject. Most blind people are age sixty-five or older. The retirement test affects blind retirees in precisely the same way that it affects all senior citizens age sixty-five to seventy. But the retirement test also affects blind people under age sixty-five who receive Social Security benefits.

According to information available from the Social Security Administration we estimate that this latter group is made up of about 104,300 blind beneficiaries. There are in addition approximately 57,000 blind individuals (most of whom are of working age) who receive Supplemental Security Income (SSI) payments but do not also receive disability insurance checks. This adds up to an estimated total of 161,300 blind beneficiaries whose work patterns and earnings could be significantly improved by work incentives.

Until 1996, under a provision in section 223(d)(4) of the Social Security Act, working-age blind individuals were subject to the earnings limitation which was precisely the same as the earnings limitation for age sixty-five retirees. This limitation is stated in section 203(f)(8)(D) of the Social Security Act. However, in 1996, an amendment to the Social Security Act was attached to a debt ceiling bill. This changed the law by creating an earnings limit for the blind which is different from the earnings limit for age sixty-five retirees. As a result, the earnings limit for the blind of working age is far more severe than the earnings limit which applies to retirees. For this reason, while we enthusiastically support further changes in the earnings exemption threshold for seniors, we are asking the Committee and the Congress to exclude the conforming amendment passed in 1996 from any future bills and hence, re-establish the link between the blind and seniors earnings exemption thresholds.

RATIONALE

In terms of establishing the point at which an individual becomes eligible, the Social Security Act treats blindness and retirement age (age sixty-five) in almost precisely the same manner. Section 216(l)(1) of the Act presently defines retirement age as age sixty-five. The definition of blindness is found in section 216(i)(1)(B). In looking at this definition it is critical to understand that blindness is not the same as disability.

The definition of disability is an "(A) inability to engage in any substantial gainful activity . . . , or (B) blindness; . . . ." In the latter case (blindness) the inability to perform "any substantial gainful activity" is not a defining condition. Blindness is defined by means of specific visual acuity and field restrictions. Medical evidence is used to determine whether an individual has impaired eyesight to the extent of blindness. The determination is as clear as it is in the case of determining whether a given individual has reached retirement age.

Substantial Gainful Activity (SGA) is the test for eligibility for persons who are disabled. In such cases, the SGA guidelines are applied to determine the extent of the disability and its relationship to an individual's ability to work. Earnings are considered, but the SGA guidelines go far beyond that. Factors such as "comparability and worth of work" tests are also applied. The purpose of an SGA evaluation is, therefore, to determine whether the individual is disabled. Disability is actually defined by an individual's "inability to perform SGA." The determination of blindness under the Social Security Act does not depend upon an SGA finding.

Although blindness is defined medically and not by SGA as just described, there is an SGA guideline for blind people. This is the earnings limit which is also established for age sixty-five retirees. Also, in Title XVI (SSI) no SGA determination is made in the case of blind individuals. They are categorically eligible. This is exactly the same situation for persons who have reached age sixty-five. They, too, are categorically eligible for SSI. Of course, income and resources may affect eligibility or payment amounts for any individual (age 65 or blind), but the ability to work does not affect eligibility. This is as it should be.

Unlike SSI, eligibility under Title II is not means-tested. Social Security benefits are paid to wealthy people and to poor people alike. True to the principles of insurance, not welfare, income for Social Security beneficiaries can be unlimited, but work activity is limited. For blind people as well as for retirees this is a counterproductive policy, and it is so for precisely the same reasons.

Blindness as we still experience it today has profoundly adverse social and economic consequences. Therefore, Social Security benefits should offset these consequences insofar as possible. The social attitudes about blindness are full of myths and misconceptions. As a group, the blind face an incredibly devastating set of artificial impediments when they seek to enter and compete in the labor force. The blind are not just viewed as unemployed. We are usually considered unemployable.

To be sure, the blind pay a heavy price for this erroneous labeling. For example, most people agree that over seventy percent of the employable blind population is either unemployed or underemployed. If before blindness an individual had an income of, say, $25,000.00 annually (not an uncommon income for sighted individuals), and if after blindness that same individual finds employment at $14,000.00 annually (not at all an uncommon experience for the blind), he or she will still not be eligible to continue receiving Social Security benefits despite the fact that a substantial loss of income has occurred.

Under prevailing social conditions, blind people are pushed aside in competition for jobs and social opportunities. This results in significant lost income which is not replaced by Social Security. Responsibility for the prevailing attitudes about blindness does not rest with the blind alone; it is a general social phenomenon. However, it is the blind members of our society who currently bear the cost in lost opportunities, lost jobs, and lost income.

The Social Security system itself presents additional economic barriers to the full integration of the blind. I am referring to the direct impact of the earnings limitation. These are the stark economic realities: under existing law, if an individual becomes blind and has average monthly earnings which do not exceed the "exempt amount," he or she will likely draw Social Security benefits. The individual has every incentive to remain unemployed and not return to work at all. Why? In the first place, the beneficiary is undoubtedly not an expert in the law. The law is complex, and the talk of allowed earnings, trial work periods, impairment-related work expense deductions, and extended eligibility is confusing and not generally conducive to an attempt to resume or continue working.

Ironically, the work incentives for blind people under Social Security are inversely related to the likelihood that an individual can engage in productive activity. For example, persons who are age seventy and older have the maximum incentive to work—there is no limitation on their earnings. Persons age sixty-five to seventy are faced with the disincentive of an earnings limitation, but their earnings exempt threshold is gradually increasing at a much higher rate than the blind and two-thirds of their earnings are still exempt. Blind persons under age sixty-five are subject to the harshest penalty of all—there is an absolute barrier to earnings over the exemption threshold. If the individual goes to work and (after a specified trial work period) is earning somewhere in the neighborhood of $1,110.00 per month, benefits will be terminated.

Place yourself in the position of a blind person considering possible employment. Remember that, including dependents' benefits, the family income from Social Security may exceed $1,500.00 per month in many instances. I know a number of blind people who (believing in the work ethic) would accept employment offering gross wages at somewhat less than their possible Social Security income. However, many people are simply not in a financial position which would allow them to do so. Of course, there are also costs associated with working that any blind person must consider. These costs may include employment of readers or drivers or other assistants, which will further reduce take-home pay. When all of these costs are taken into account, many individuals find that they cannot sustain the economic losses which may result from working.

In the example under consideration the annual Social Security benefit available to the primary beneficiary and dependents would be approximately $18,000.00. The blind beneficiary who, under present law, earns $13,340.00 ($20.00 over the limit) would lose $18,000.00. Almost anyone I know would have to refuse to take a job which would cost $18,000.00 a year as a trade-off for earning $13,340.00. This is precisely the kind of economic choice presented to blind beneficiaries under the present law.

Taking the example a step further, it is revealing to examine just how much the primary beneficiary would need to earn, if working, in order to replace the loss of $18,000.00 in Social Security benefits. Using conservative numbers, such as 28% for all taxes (including FICA withholding) and taking into account the cost of working (transportation, meals away from home, blindness-related work expenses, union dues, et cetera), I would estimate that the working blind individual would need to have an income of $27,917.00, not including child care expenses. Since the example includes two dependents, child care expenses can be anticipated. A conservative estimate for child care would be approximately $4,600.00. This amount added to $27,917.00 means that the working blind beneficiary with two dependents in child care would likely need to have gross income of $32,517.00 in order to replace the buying power of the Social Security income—$18,000.00—if lost due to working.

With the amendments to the Social Security Act passed in 1996, benefits for seniors are increasing during a seven year period in order to reach an annual ceiling of $30,000.00 in the year 2000. This policy of mandated adjustments for seniors is a good one. However, it should apply to blind people and to age sixty-five retirees alike. As I have already said, the conforming amendment which excluded the blind from the earnings limit change in 1996 should not be included in future bills of this type.

The policy of linking the earnings limit for the blind and for seniors became law with the 1977 amendments to the Social Security Act. Mr. Archer, who was at that time the ranking minority member of this Subcommittee and is now the Chairman of the full Committee, is the architect of this policy. The amendment which he offered to create the linkage was approved with unanimous Republican support when the conferees met to resolve differences between the Senate and House versions of the Social Security Financing Amendments of 1977.

The 1977 bill contained five mandated increases in the earnings exemption threshold, with automatic annual adjustments kicking in beginning in the sixth year. Under Mr. Archer's amendment both blind people and seniors were subject to the mandated increases as well as to the automatic adjustments. The current mandated adjustments to seniors' exempt earnings threshold are the first since 1977's provisions. The precedent clearly establishes that both the mandated increases and the annual adjustments should apply to blind people as well as to age sixty-five retirees.

If this is done the blind person who earns less than $30,000.00 could not lose by working. This policy, while not removing the earnings limit altogether, would cover the vast majority of blind people. The harsh reality of the choice to receive benefits or to work would seriously be diminished, and it would be replaced by an extremely powerful work incentive. The beneficiaries who respond will become taxpayers, and they will join the productive ranks of our society. The blind person is better off being productive. Society in general is better off if the individual is productive instead of idle—working instead of sitting at home.

Proponents of the earnings limitation complain that individuals with high earnings will continue to receive Social Security benefits. The fact is that the number of blind people being paid $13,320.00 a year or more is surprisingly small. Most blind people do not even work. Approximately 161,300 blind persons under age sixty-five now receive Social Security or SSI benefits. They would not be paid more as a result of increasing the earnings exemption threshold. They would have the maximum incentive to work, and thousands would begin paying into Social Security.

By comparison, raising the earnings exemption threshold would add some blind persons as new beneficiaries but this would only be a fraction of the more than 160,000 who are now beneficiaries. The new beneficiaries would be individuals who earn more than the present exempt amount but less than $30,000.00. Although they would begin to receive benefits, there would be an overall positive effect on the Social Security system. That would result from providing a powerful incentive to work to more than 160,000 beneficiaries who would not receive one dime more from Social Security. Besides, fewer blind individuals would receive SSI as a result of becoming Social Security beneficiaries.

Overall, there would actually be a positive cost impact on the Social Security system resulting from increased payments into the trust funds by working blind beneficiaries. The greater their earnings, the greater will be the amount that they pay into the trust funds. Considering the costs and benefits involved, the provision which withholds the mandated earnings limit adjustments from blind people is truly punitive.

In conclusion, I would like to restate our long-standing position about work incentives and the counterproductive impact of the Social Security earnings limitation. The blind as a group are prepared to work—and work hard. The disincentives created by Social Security force blind people into financial dependence. We seek to renounce this status. We are asking only for the opportunity to lead normal, self-supporting, independent lives. If there continues to be a limitation on earnings, those who are subject to it will be paid to remain outside of the work force. This policy reinforces the myth that the blind cannot be productive members of society. Until that myth is changed, we will be subject to the conditions of ignorance, prejudice, and discrimination which have long kept blind people out of the mainstream. We are committed to use work incentives effectively as instruments of rehabilitation, self-help, and self-support for the blind. As Congress considers ways to create a more viable and solvent Social Security System, developing policies which support independence verses dependence will be crucial.